OCTOBER 2023

GUIDE

State Budget Law Proposal for 2024

Law Proposal 109/XV/2

CUATRECASAS

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1. Introduction

Following the government's presentation of the 2024 State Budget Law Proposal ("2024 State Budget Proposal"), Cuatrecasas presents a summary of the main measures included in the proposal and highlights those that may have a direct impact on its clients.

The 2024 State Budget Proposal is an exercise in budget prudence with non-expansionist measures, which is symptomatic of the various factors of uncertainty associated with the international economy. The tax policy measures presented are conservative to a certain extent and favor the stability of the tax framework and the reduction of public debt to bolster the resilience of the national economy against possible adversities in an unstable international economic framework.

Still, we can emphasize some positive measures, such as the lowering of the personal income tax ("IRS") brackets, the better tax treatment for young people (*IRS Jovem)*, the company capitalization incentive, and other tax benefits aimed at boosting the income of Portuguese families. Another notable point is the migration of pending tax court cases to tax arbitration, which could speed up decisions in cases that have been in the first instance courts for more than two years.

Regarding measures of questionable merit, the end of the Non-Habitual Resident (NHR) regime and its replacement with a tax incentive regime for scientific research and innovation is less appealing and more bureaucratic than the NHR regime.

All we can do is wait for the parliamentary discussions on the proposal and for any changes that may be made at the specialty stage. We will of course pay close attention to these and the impact they may have on Cuatrecasas's clients.

2. Timeline

October 10, 2023

Presentation of the government's law proposal.

Proposal entered Parliament

October 26 to 31

General appraisal

General vote
on October 31, 2023

November 2 to 29

Appraisal at the specialty stage

Overall final vote
on November 29, 2023

December 14, 2023

Establishing the final wording

December

Signing into law by the President of the Republic

By December 31, 2023

Publication in the Official Gazette

January 1, 2024

Entry into force

Although changes to the 2024 State Budget Proposal are possible during the parliamentary discussions, the government is backed by the parliamentary majority of the socialist party ("PS"), so the final text of the 2024 State Budget is unlikely to differ significantly from the presented proposal.

3. End of NHR regime

The current NHR regime provides taxpayers with a more favorable personal income tax treatment:

Portuguese-sourced employment and self-employed income from listed high value-added activities are taxed at a 20% flat rate.

Foreign-sourced pension income is taxed at a 10% flat rate.

Foreign-sourced income (excluding pension income) may be exempt if certain criteria are met relating to state-of-source taxation rights for all types and categories of income under applicable double tax treaties.

The 2024 State Budget Proposal foresees **the end of the current NHR tax regime, starting January 1, 2024**.

Impact:

If the text is not changed during the parliamentary discussion, **anyone wishing to move to Portugal from January 1, 2024, will no longer be able to apply for NHR status** under the current regime.

Are the rights of current NHR taxpayers grandfathered?

Under the 2024 State Budget Proposal, taxpayers who already have NHR status will be able to continue benefiting from the current NHR regime until their 10-year period ends.

Can taxpayers moving to Portugal until the end of 2023 still apply for NHR status?

Anyone planning to move to Portugal **before December 31, 2023,** may have a window of opportunity to acquire tax residency in Portugal and apply for NHR status under the current regime and benefit from it for a 10-year period.

However, to qualify:

- they will have to meet the Portuguese tax residency criteria;
- they will have to register with the Portuguese tax authorities; and
- non-EU citizen taxpayers will have to get a head start on immigration authority procedures.

3. End of NHR regime

3.1 New tax incentives to attract people to Portugal

New tax incentive for scientific research and innovation

The 2024 State Budget Proposal plans to add a new tax incentive for scientific research and innovation to the Portuguese Tax Incentives Code. The incentive will be available to taxpayers who become tax residents of Portugal, starting in 2024, have not been tax residents of Portugal in the past five years, and earn income from the following:

- Teaching careers in higher education and scientific research
- Qualified jobs with contractual benefits related to productive investment specifically provided for in Portuguese law
- Research and development jobs for employees with a minimum qualification equivalent to a doctorate degree, the costs of which are eligible for the tax incentives system for research and business development specifically provided for in Portuguese law

This new tax incentive resembles the NHR regime for high value-added activities. It proposes a **reduced tax rate of 20%** on the net salary and self-employment income from these jobs and activities for a **10-year** period, starting in the year these taxpayers register as tax residents of Portugal.

Taxpayers eligible for this new tax incentive may also benefit from an exemption from income tax on various types of foreign income, excluding pension income. However, foreign income paid by nonresident entities without a permanent establishment in Portugal and domiciled in a blacklisted jurisdiction will not be tax-exempt; instead, this foreign income will be taxed at an increased rate of 35%.

Important notes for applicants:

Taxpayers who:

- have benefited from or continue to benefit from the NHR regime; or
- applied for the Return Program *(Programa Regressar)*

cannot apply for this new tax incentive.

A taxpayer can only use this new tax incentive once.

3. End of NHR regime

3.1 New tax incentives to attract people to Portugal

- **Return Program**

The 2024 State Budget Proposal also plans to extend the existing Return Program so that it applies to taxpayers who become tax residents in Portugal until 2026 and who have not been tax residents of Portugal in the past five years.

One of the other requirements to be eligible for this program was to have been a tax resident in Portugal in the past in specific years. This requirement of prior residence will be eliminated, with the Return Program opening up for foreign individuals who have never been tax residents of Portugal.

The Return Program allows for a 50% tax exemption on employment and self-employment income up to €250,000 annually for the first five years of residence.

Practical conclusion from the comparison of the new incentives and the current NHR regime that will be terminated:

- In place of the NHR regime, the 2024 State Budget Proposal creates a new tax incentive for scientific research and innovation, but the new regime has a much narrower scope of application. The only beneficiaries are taxpayers with teaching careers in higher education and scientific research, jobs that qualify for the tax benefits established in Portuguese law for production investment, and research and development jobs for those who hold at least a PhD and are eligible for the corporate R&D tax benefits system under the Tax Incentives Code.
- Extending the Return Program to foreigners who have never been tax residents in Portugal could also act as a partial replacement for the NHR regime, although it has a much narrower scope (employment, self-employment and professional income) and duration (only for a period of five years).

4. Tax benefits for companies

4.1 Tax incentive for salary increases

- The 2024 State Budget Proposal reformulates the tax incentive for salary increases, and fleshes out the criteria for its application. The tax incentive for salary increases was created in the 2023 State Budget Law and provides that the costs involved in salary increases for employees with a permanent employment contract can be increased by 50% of the respective amount if certain requirements are met. In the 2024 State Budget Proposal version, the costs relating to employees covered by a dynamic collective bargaining instrument (IRCT)—whose remuneration has increased by at least five per cent more than the guaranteed monthly minimum salary (currently, it must be at least 5.1 percent)—must be considered. This wording raises interpretational doubts which are expected to be clarified in the final version of the State Budget, specifically as to which costs are eligible for the purposes of the benefit, if they derive from salary increases determined under a dynamic IRCT, or from salary increases for employees covered by a dynamic IRCT, although these increases do not necessarily have to be determined under a dynamic IRCT.
- Collective conventions, collective contracts, collective agreements or company agreements, adhesion agreements and arbitration awards in voluntary arbitration proceedings are included in the concept of IRCTs. A transitory regime is established: extension ordinances and working conditions ordinances may be included in the concept of IRCT in the 2023 and 2024 tax years.
- The concept of salary range is calculated as the ratio between the portion of the annual fixed remuneration of 10% of the highest paid employees and the portion of the annual fixed remuneration of 10% of the lowest paid employees in relation to the total. The purpose of this legislative change is simply to bring into the Tax Benefits Statute ("TBS") the salary range concept described by the tax authority in Circular 202260/2023, since this concept is currently defined by law only as the difference between the annual amounts of the highest and lowest fixed remuneration of the employees, calculated on the last day of the relevant tax year.
- Expenses incurred by members of corporate bodies are now eligible for the benefit, while employees who hold a qualified majority of the company's capital, as well as members of their household, are not eligible.

4.2 Incentivizing company capitalization

- Instead of a taxable income deduction equivalent to applying a fixed rate of 4.5% to net increases in eligible equity, the proposal is to deduct an amount equivalent to applying the average 12-month Euribor rate for that tax year, calculated on the last day of each month, plus a spread of 1.5 percentage points (or 2 percentage points in the case of SME or Small Mid Cap enterprises), to the net increases in eligible equity.
- The tax benefit should be quantified using the net increases in eligible equity calculated in that financial year and in the previous six financial years (as opposed to the current nine years).
- In addition, the deduction will increase by 50%, 30% and 20% in the 2024, 2025 and 2026 tax years, respectively, subject to the limits for the application of this tax benefit.
- In this way, the combination of the above increase and the reduction in the number of years considered for calculating the tax benefit should result in an earlier use of this benefit than under the current wording.
- The exclusion of capital increases financed through loans granted by the taxable person itself or by an entity with which it has a special relationship is also strengthened—the presumption is that the capital increases were financed by these loans, unless the taxable person can prove that they were used for other purposes.

4. Tax benefits for companies

4.3 Contractual tax benefits for production investment and the Tax Regime on Investment Support ("TRIS")

- The salary costs involved in creating jobs for employees with a master's or doctorate degree in investment projects covered by these tax benefits will now be considered relevant investments. These jobs must be maintained for a minimum of five years (or three, in the case of SMEs). The aim of this measure is to attract employees qualified in the areas of scientific research and innovation.
- In the case of the TRIS, when companies do not qualify as micro, small or medium-sized enterprises, these salary costs and investments in intangible assets cannot exceed 50% of the relevant investments.

4.4 Extraordinary support regime for electricity and gas costs

- The extraordinary support regime for electricity and gas costs that establishes a 20% increase in the costs and losses incurred or borne with electricity and natural gas consumption to the extent that they exceed those of the previous tax year will continue in 2024 for corporate income tax ("IRC") taxpayers and IRS taxpayers with organized accounting.
- The 2024 State Budget Proposal clarifies that this incentive is not relevant for the purpose of the IRC assessment result in the 2024 tax year, and that increases that cannot be used in the 2022 and 2023 tax years because they exceed the limit on that result can be carried forward to the following 12 tax years.

4.5 Tax incentives for renewing goods transport fleets

- An IRC exemption is introduced for the positive difference between capital gains and capital losses made in the 2024 tax year when these derive from the for-value transfer of goods vehicles weighing 35 metric tons or more, acquired before July 1, 2021, and first registered before that date.
- This exemption will be contingent on the corresponding realization value being fully reinvested, in either that tax year or by the end of the following tax year, in goods vehicles that meet certain requirements.
- The vehicles in which the reinvestment is made must remain registered as tangible fixed assets of the taxable person for a period of five years.

4. Tax benefits for companies

4.6 Extraordinary support regime for agricultural production costs

- In 2024, the extraordinary support regime for costs incurred in agricultural production will continue to apply for IRC purposes. This consists of a 40% increase for the costs and losses incurred or borne for the purchase of certain goods associated with agricultural production (e.g., fertilizers, meals, cereals and seeds for feeding livestock, poultry and other animals).
- The amount of the benefit that is not used in the tax year starting on or after January 1, 2024, because it exceeds the limit imposed by the assessment result rules may be deducted from the assessment result until the following 10th tax year.

4.7 Common Agricultural Policy ("CAP") tax incentives

- Taxable persons that receive CAP subsidies or grants in 2024 for the previous year may choose to have these included in that year for IRC purposes.
- Therefore, if the subsidies or grants are paid after the general deadline for submitting tax returns, they can file a substitute return.

4.8 Tax incentives for culture - legislative authorization

The government is granted legislative authorization to create, in the 2024 tax year, a tax incentive for film and audiovisual production in the national territory, with the following meaning and scope:

To create a deduction from the IRC tax base calculated on film production expenses for operations carried out in Portugal to make film and audiovisual works, and with a total eligible expenditure of at least €1 million per film or audiovisual work, or season of episodes.

To establish mechanisms to ensure the use of this IRC incentive by taxable persons that do not have a sufficient IRC tax base for the deduction.

4. Tax benefits for companies

4.9. Tax benefits extension

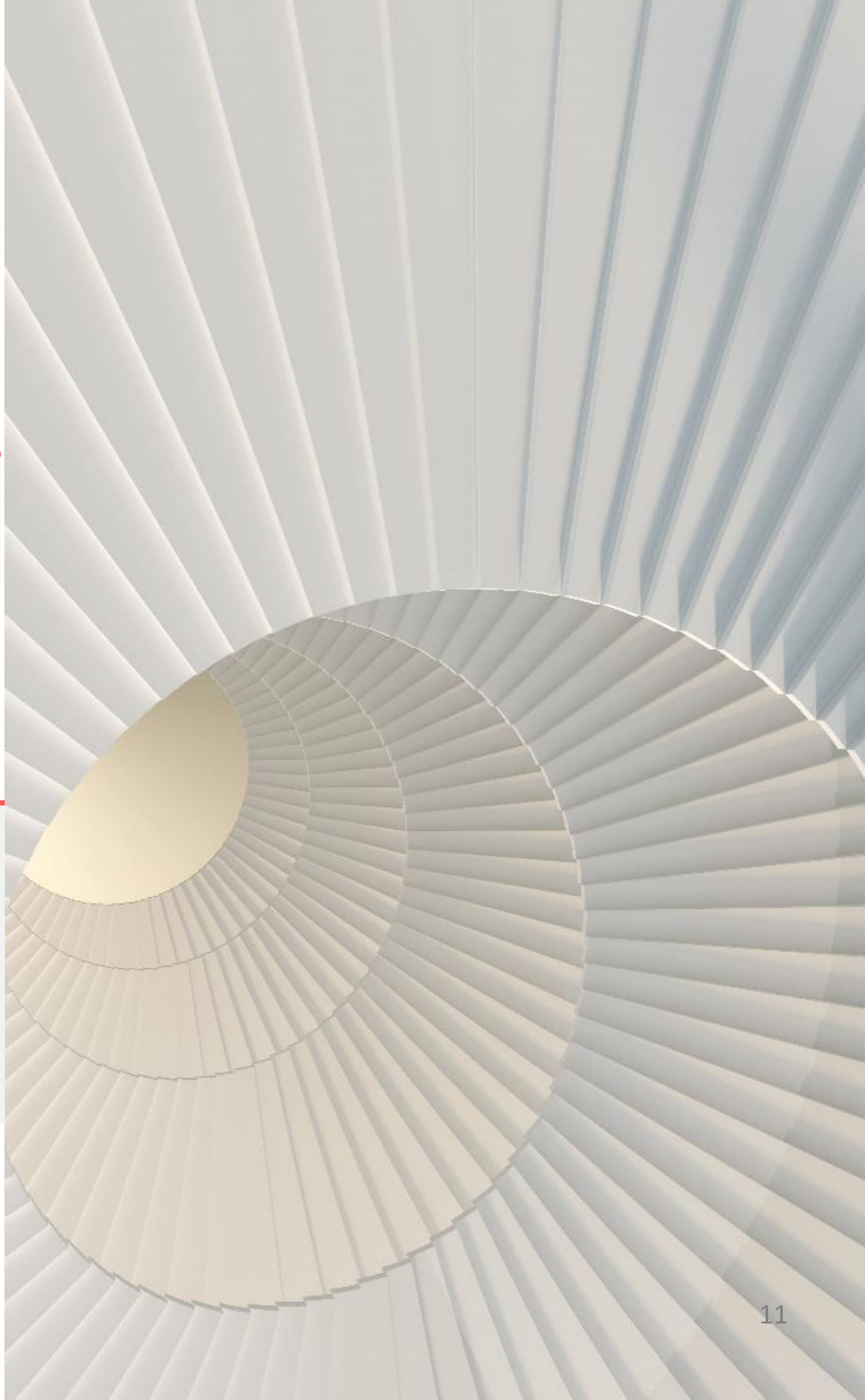
- The following tax benefits have been extended until December 31, 2024:

Film and audiovisual production	Tax incentives for forestry activities	Forest management entities and forest management units	Deductions relating to social impact bond partnerships	Solar and electricity-powered or electric-only vessels.

- **The general rule on the expiry of tax benefits (five years) no longer applies to the tax benefit established in article 27 of the TBS**, which includes an exemption from capital gains made by nonresidents on the for-value transfer of shares:

Article 27
Capital gains made by nonresident entities

1. Capital gains on the for-value transfer of shares, other securities, autonomous warrants issued by entities resident in Portuguese territory and traded on regulated stock exchange markets, and financial derivatives traded on regulated stock exchange markets, by entities or individuals that are not domiciled in Portuguese territory and do not have a permanent establishment there to which these can be attributed, are exempt from IRS and IRC.



5. Measures that impact companies and employees

5.1 Reducing the autonomous levy (*tributação autónoma*) rates

- The autonomous levy rates for expenses incurred or borne by light passenger vehicles, certain light goods vehicles, motorcycles or mopeds will be reduced as follows:

8.5% to 10% for vehicles with an acquisition cost of less than €27,500	25.5% to 27.5% for vehicles with an acquisition cost between €27,500 and €35,000	32.5% to 35% for vehicles with an acquisition cost of €35,000 or more

- It is also clarified that expenses connected with electric-only vehicles are not subject to the autonomous levy when these are:

(i) light passenger vehicles, motorcycles or mopeds used for a public transport service and intended for rental in the taxable person's normal business; or

(ii) vehicles for which the employee and employer have entered an agreement to allocate the vehicle to the employee.

5.2 Acquisition cost of intangible assets

- For the purposes of amortizing certain intangible assets, recognized for autonomous levy purposes, the acquisition cost is now considered tax deductible in equal parts over the first 15 (currently 20) tax years after initial recognition, relating to goodwill recognized as part of a business combination.

Time of application?

These rules apply only to assets which, under the accounting legislation, are initially recognized in tax years starting on or after January 1, 2024.

5. Measures with an impact on companies and employees

5.3 Employee allowances and compensation for using their own vehicles to travel

- The proposal is to eliminate the current reduction in the amount of the daily allowances and transport allowances paid to state employees and restore the previous amount by excluding the amounts paid from IRS within the set limits as daily allowances and compensation for using their own vehicles to travel.

Travel		2023 amount	2024 amount
Own car		€0.36/Km	€0.40/Km
Employees	National travel	€50.20	€62.75
	Foreign travel	€89.35	€148.91
Government members and their equivalent in the private sector (executives)	National travel	€69.19	€69.19
	Foreign travel	€100.24	€167.07

5.4 IRS exemption on bonuses awarded for balance sheet bonuses

- The 2024 State Budget Proposal includes an IRS exemption of up to five times the guaranteed monthly minimum salary (5 x €820.00 = €4,100.00) on the amounts paid to employees as a share of company profits through a balance sheet bonus, paid by entities that have an average nominal increase of 5% or more in fixed remuneration per employee in 2024.

How is the exemption applied?

This is a progressive exemption and the exempt income described above must be combined for the purposes of ascertaining the IRS rate to be applied to the employee's other income.

6. Startups

6.1 Reducing the IRC rate

- Startups that qualify as micro, small, medium or small-medium capitalization enterprises (SmallMidCap) will now be subject to 12.5% corporate income tax (currently 17%) on the first €50,000 of taxable income.

6.2 IRS incentive for the purchase of shares in startups

- The regime applicable to the purchase of shares will now apply to companies recognized as startups in the year the plan is approved if this is the company's first year of business (currently, only companies recognized as startups in the year before the approval of the plan were covered).
- In cases of loss of Portuguese resident status, the gains will refer to the time the option or right is exercised and will be partially exempt from IRS on up to 20 times the Social Support Index ("IAS") and are combined for the purpose of ascertaining the rate to be applied to the remaining income. This exemption can only be used once.
- It is clarified that, for the purposes of the regime, an employer is considered any entity that pays or makes available remuneration that constitutes employment income, and any other entity that is in a group, control or simple shareholder relationship with it, regardless of its geographical location, is also considered an employer.
- In addition, members of the corporate bodies of the entity granting the plan will now be eligible for this benefit.

6.3 Extending the timeframe of the IRS incentive to the purchase of startup shares

- On the date the new regime enters into force, employees still holding the securities that generated the gains that benefited from the IRS exemption established in the previous regime —article 43-C of the TBS, with the wording prior to the entry into force of the new IRS incentive for the purchase of startup shares—can keep the IRS exemption if they keep the securities for a minimum of two years after they exercise their option or subscription.
- Gains from the for-value sale of securities or similar rights deriving from plans acquired before the new regime enters into force and whose holders benefited from the regime that preceded the entry into force of the new IRS incentive for the purchase of startup shares will be taxed under category G. These will be calculated as the positive difference between the realization value and the market value on the date the option or right is acquired.

What regime applies to startups?

Law 21/2023 of May 25 (Startups Law) introduces and defines the concepts of startup, scaleup and business angel. The granting of this status to a legal person is contingent on certain requirements being met.

The recognition of a startup or scaleup is done through prior communication to Startup Portugal through the public services one-stop shop.

For more on this topic, see the Legal Update published on June 1, 2023: Legal Regime on Startups and Scaleups

7. Housing

7.1 Tax incentive for employee housing

- **IRS:** An exemption from IRS and social security contributions is proposed for non-monetary employment income (category A) deriving from the use of a permanent residence located in Portugal, provided by the employer, and referring to the period between January 1, 2024, and December 31, 2026, up to the rent cap established in the Rent Support Program (see limits established in Ordinance 176/2019 of June 6).
- **IRC:** Taxable persons—employers—that own, build, acquire or convert real estate for employee housing and benefit from this housing tax incentive are allowed a faster depreciation of that real estate equivalent to double the rate established in Regulatory Decree 25/2009 of September 14, as amended; i.e., a rate of 4% (as opposed to the current 2% rate).

7.2 Stamp duty exemption on mortgage loans

- A stamp duty exemption is proposed on the use of credit in the context of operations to temporarily fix the installment and capitalization of the approved amounts in housing loans covered by the measure set out in Decree-Law 91/2023 of October 11, which establishes the measure to temporarily fix the installments of loan agreements for the purchase or construction of owner-occupied housing and boosts the extraordinary measures and support relating to housing loans.

7.3 Municipal property tax ("IMI") exemption for renovated buildings let as permanent housing

- The existing IMI exemption for buildings that have been newly built, extended, improved or purchased for valuable consideration (when it is the first transfer), which are let for residential purposes, should now apply exclusively to cases where the building is let as the tenant's permanent home (currently, any housing rental is covered).

7.4 Updating the municipal property transfer tax ("IMT") tax brackets

- The IMT tax brackets for the purchase of residential buildings are to be raised by 5%.

Are there any IRS exclusions with this incentive?

Income earners that directly or indirectly hold at least 10% of the employer's share capital or voting rights cannot benefit from this exemption.

Beneficiaries of the stamp duty exemption?

Borrowers of mortgage loans for owner-occupied housing with a variable or mixed interest rate in a variable rate period, contracted by March 15, 2023, and with a remaining term of more than five years, covered by Decree-Law 91/2023 of October 11, which establishes the measure to temporarily fix the installments of loan agreements for the purchase or construction of owner-occupied housing and boosts the extraordinary measures and support relating to housing loans.

8. Tax justice

8.1. Pending tax cases to be referred to arbitration

The proposal is to refer to arbitration tribunals the tax litigation proceedings that, regardless of their value:

were registered as entering the court by December 31, 2021, and

and

are awaiting a decision at first instance

The arbitral tribunal must have jurisdiction to hear the claim.

Formalities

- Filing an application to terminate the judicial proceedings; the request to form an arbitral tribunal must be accompanied by an electronic judicial certificate of the original application.
- The claim and cause of action of the case to be referred must coincide, and the claim may be reduced.
- The tax authority can revoke, ratify, reform or convert the tax act concerned within 30 days.

Possibility of appeal

For referred cases where the value of the claim exceeds €10 million, the appeal possibilities are extended and either party can appeal the arbitral decision under the general terms of the Code of Tax Procedure.

Reversing the referral

If the arbitral decision terminates the proceedings without ruling on the merits of the claim, the arbitral tribunal will refer the terminated proceedings back to the tax court. This reverses the termination of the proceedings, which will then continue as they were prior to the request to form the arbitral tribunal.

8.2 . Withdrawal of the claim

In judicial review proceedings awaiting a decision at first instance, the application can be withdrawn. In this case, 25% of the amount of the court fees paid will be refunded and the remainder of the court fee is not payable.

9. Other substantial changes

- **Updating the IRS brackets:** It is proposed to decrease the general tax rates for the five lower brackets and raise each bracket by around 3%, leading to a general reduction in taxation.

- ***IRS Jovem*:** it is proposed to increase the IRS exemption limits on employment income (category A) and business or professional income (category B) earned by young people to the following percentages:

  (i) 100% in the first year (currently 50%), capped at 40 times the IAS (40 x €510 = €20,400.00)

  (ii) 75% in the second year (currently 40%), capped at 30 times the IAS (30 x €510 = €15,300.00)

  (iii) 50% in the third and fourth years (currently 30%), capped at 20 times the IAS (20 x €510 = €10,200.00)

  (iv) 25% in the fifth year (currently 20%), capped at 10 times the IAS (10 x €510 = €5,100.00)

  The IAS update is not included in the 2024 State Budget Proposal and will be published in an ordinance. However, the State Budget Report indicates that it will be updated according to the legal formula for this purpose and is expected to increase by 6.2% to €510.

- **Restriction of the scope of application of the Energy Sector Extraordinary Contribution ("ESEC"):** operators that transport crude oil and oil products are excluded from the scope of the ESEC if this activity does not represent more than 50% of their total annual turnover.

  In addition, assets will no longer be subject to the ESEC if they are included in those classified by the Portuguese Environment Agency, under the European regime for the promotion of sustainable investment, as a substantial contributor to:

  (i) climate change mitigation

  (ii) adaptation to climate change

  (iii) sustainable use and protection of water and marine resources

  (iv) transition to a circular economy

  (v) pollution prevention and control

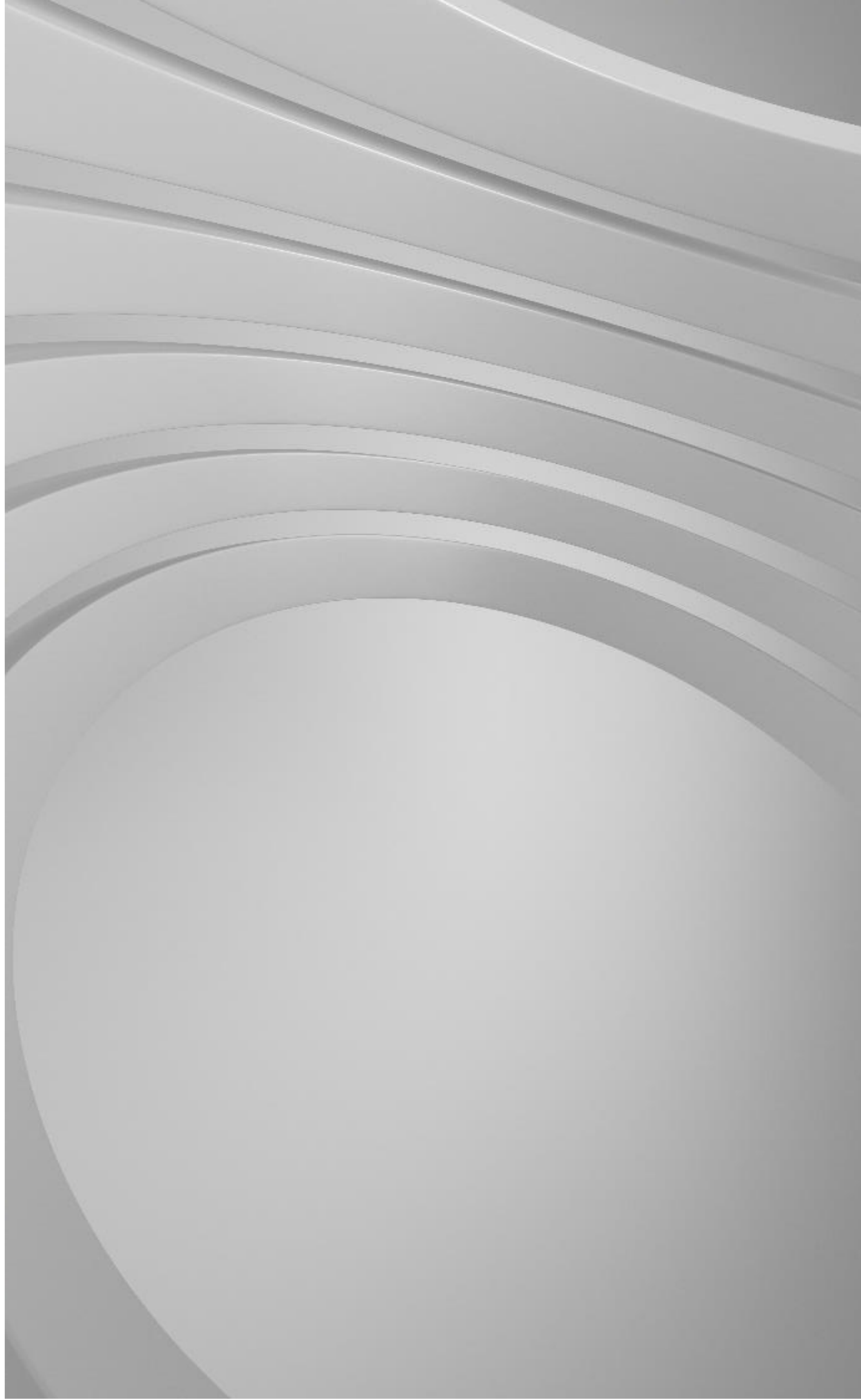
  (vi) protection and restoration of biodiversity and ecosystems

9. Other substantial changes

- **VAT refund on organization of events by travel agencies:** Travel agencies will now be able to benefit from a refund of the VAT paid on expenses connected with transport and business travel, accommodation, food and drinks in the context of organizing congresses, fairs, exhibitions, seminars, conferences and similar events.

- **Tobacco tax:** It is proposed to extend the tobacco tax to include nicotine-free liquids for electronic cigarettes.

- **Contribution on very light plastic bags:** A contribution of €0.04 is created on very light plastic bags. These are the bags used for the bulk sale of bakery products, fresh fruit and vegetables.



Final note:

The government law proposal referred to in this document (Law Proposal 109/XV/2) is still at the parliamentary appraisal stage and may be changed during the approval process.

This document has been prepared based on the initial version of the law in question, which entered Parliament on October 10, 2023.

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