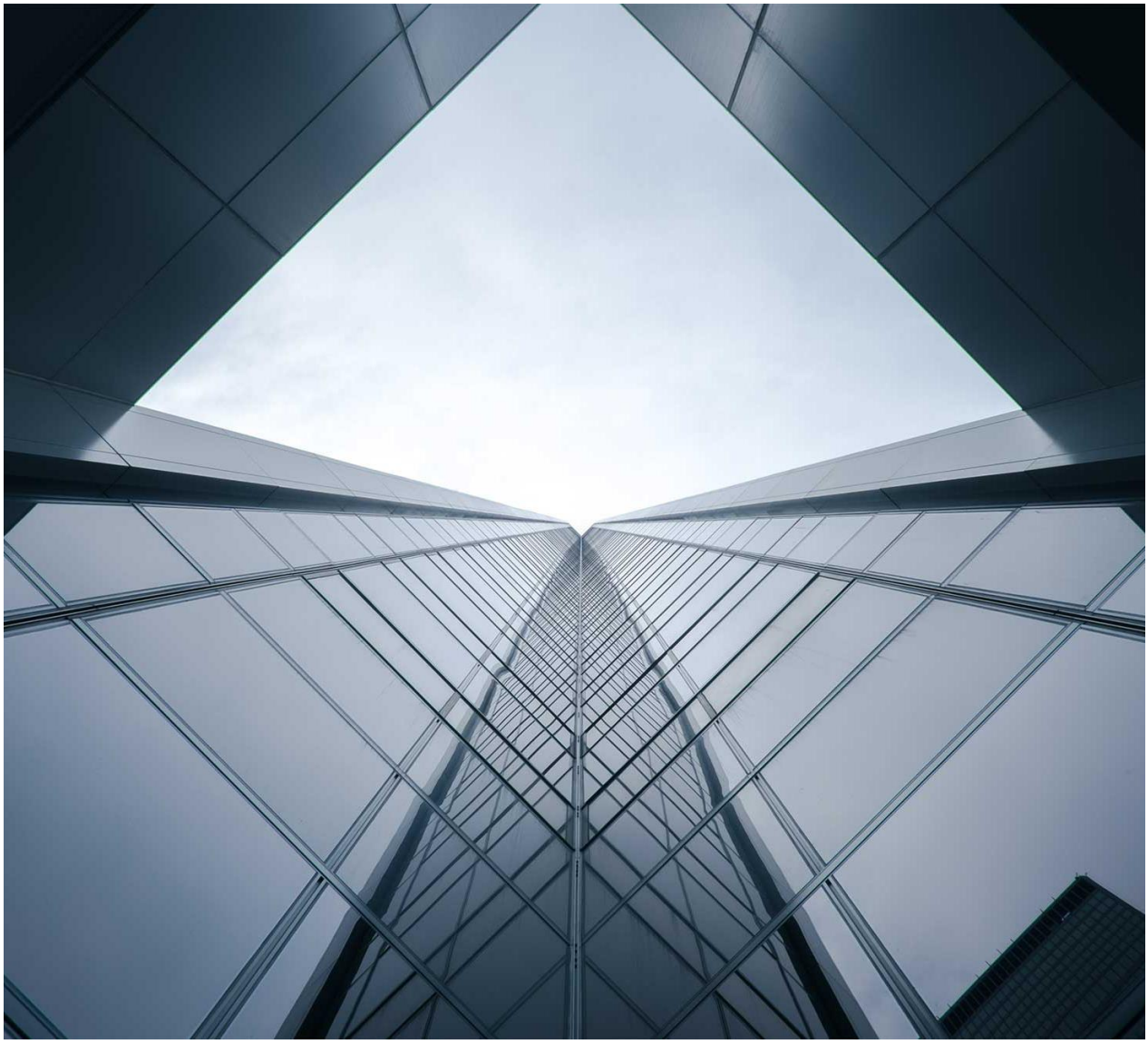
CUATRECASAS

Tax



3rd Quarter 2023 | November 2023

Contents

Editorial

The third quarter of 2023 was dominated by the preview of the measures to be included in the State Budget Law Proposal and its preparation by the government, together with the debate surrounding the **More Housing Program**. This had also been the case in the previous quarters, as well as in the implementation of the **Avançar Program** approved by Ordinance 187/2023 of July 3, which included:

- the granting of financial support for employers to enter permanent employment contracts with young unemployed persons aged 35 and under with a higher-level qualification, registered with the Employment and Vocational Training Institute ("**IEFP**"), and for a contractually established remuneration of at least €1,330;

- the direct granting of financial support directly to young people to help them become independent;

- the granting of financial support for (a) hiring young persons, subject to certain conditions; (b) paying social security contributions, subject to certain conditions; and (c) helping young people become independent.

These measures can also be combined with other tax or parafiscal employment incentive measures.

Also, from a legislative perspective, Ordinance 292-A/2023 of September 29, on setting the caps for the compensation payable to employees for additional telework expenses was approved.

As regards international taxation, we have followed the subject of the Capital Raising Directive ("**CRD**") and its impact on stamp duty, which we discuss in one of the articles in this newsletter. It is also clear that the timely transposition of Council Directive (EU) 2022/2523 of December 14, 2022, will be difficult or even impossible at this stage. This directive, aimed at ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (known as Pillar Two), should have been transposed by the end of this year.

Regarding administrative doctrine, the Tax and Customs Authority has issued several letters aimed at clarifying interpretational difficulties in applying tax benefits, such as Circular Letter 20259 of June 28, 2023, on interpreting the concept of job creation and maintenance for the purposes of the Investment Support Tax Regime (RFAI) under article 22 of the Investment Tax Code. Equally important is the clarification provided by Circular Letter 20260 of September 14, 2023, regarding the criteria for applying the salary increase incentive. We will also discuss the topic of municipal tax benefits in the specialist article below.

Lastly, regarding court decisions, the Tax Arbitration Center ("**CAAD**") delivered an arbitral award defining the concept of "effective beneficiary of interest" for the first time for the purpose of waiving withholding tax (Case 776/2022-T). Also, the Supreme Administrative Court issued a judgment that standardizes previous court decisions, ruling that indemnity interest is not owed to taxpayers under article 43.1 of the General Taxation Law ("LGT") when disputed tax acts are annulled for irregularities of form (judgment delivered in Case 011/23.8BALSB of June 21, 2023).

At a time of considerable legislative and court activity, the Cuatrecasas team has been following current issues and trends in tax and parafiscal matters, and it has prepared the following opinion articles for this newsletter:

- Susana Estêvão Gonçalves and Nicolle Barbetti write about stamp duty imposed on fees for placing bonds and commercial paper on the market and its incompatibility with the CRD.
- António Gaspar Schwalbach and Tiago Martins de Oliveira address the topic of municipal tax benefits.
- Ana Helena Farinha and Tiago Martins de Oliveira discuss interest deductibility and its compatibility with the transfer pricing regime.
- Maria Inês Cotrim and Marta Correia Gonçalves comment on the capital gains reinvestment regime under the More Housing Program.

Serena Cabrita Neto,
Portugal Tax Team Coordinator

CJEU: Stamp duty on fees for placing bonds and commercial paper on the market

Incompatibility with the CRD

Susana Estêvão Gonçalves and *Nicolle Barbetti*

In a reasoned decision dated July 19, 2023, in Case C-335/22, the Court of Justice of the European Union ("**CJEU**") ruled that imposing stamp duty on fees charged for placing securities such as bonds and commercial paper on the market is incompatible with Council Directive 2008/7/EC of February 12, 2008, concerning indirect taxes levied on the raising of capital (the CRD).

The underlying assumption of the CRD is that imposing indirect taxes—including stamp duty—on the raising of capital gives rise to discrimination, double taxation, and disparities that hamper the free movement of capital. The CRD aims to harmonize the legislation of the European Union ("**EU**") Member States on this matter, thereby preventing indirect taxation on the creation, issuance, admission to quotation on a stock exchange, and making available of shares, bonds or other negotiable securities on the market, regardless of their origin.

In this respect, article 5.2.b) of the CRD states, "Member States shall not subject the following to any form of indirect tax whatsoever: (...) loans, including government bonds, raised by the issue of debentures or other negotiable securities, by whomsoever issued, or any formalities relating thereto, or the creation, issue, admission to quotation on a stock exchange, making available on the market or dealing in such debentures or other negotiable securities."

However, under paragraph 17.3.4 of the Portuguese General Stamp Duty Table ("**GSDT**"), stamp duty is imposed on any "fees and payments for financial services, including amounts relating to card-based payment transactions" that are made by or through credit institutions, financial or other legally equivalent entities, and any other financial institutions.

In this case, a Portuguese credit institution that has acted as a financial intermediary in various bond and commercial paper issues (for several issuers), providing market placement services for these securities, highlighted the incompatibility of paragraph 17.3.4 of the GSDT with the CRD.

This Portuguese credit institution, which had charged the fees and stamp duty, submitted a request for arbitration to the CAAD, as it considered that paragraph 17.3.4 of the GSDT, particularly subparagraph (b) of article 5.2, is incompatible with the CRD.

Following this request for arbitration, the CAAD requested a preliminary ruling from the CJEU on the incompatibility issues raised to determine whether (i) Article 5.2.b) of the CRD can be interpreted as precluding the application of stamp duty to fees for financial intermediation services provided by a bank relating to the placement on the market of securities, such as bonds and commercial paper; and (ii) the answer to the first question varies depending on whether the provision of the financial services is legally required or merely optional.

In response, the CJEU reaffirmed:

- the need for a broad interpretation of the prohibition of indirect taxes on the raising of capital (other than capital contributions) established in the CRD to ensure its effective application;

- that the market placement—intended to inform the public about negotiable securities offers and promote their subscription and acquisition—is so closely linked to the issuance and placement of securities in circulation, within the meaning of the CRD, that it must be considered an integral part of an overall transaction from a raising-of-capital perspective; and

- that this link is in no way contingent on the existence of a legal requirement for this service to be provided by third parties.

Therefore, the CJEU concluded that national legislation that provides for stamp duty to be imposed on fees for placing securities—such as bonds and commercial paper from new issuances—is incompatible with the CRD, regardless of whether it is legally obligatory to use a third party's services.

The CRD has been a recurring theme in Portuguese courts, given the incompatibility between the protection it confers and certain (other) sections of the GSDT.

Only recently, the CJEU ruled in the *IM Gestão de Ativos* judgment (in Case C-656/21) of December 22, 2022, on the incompatibility with the CRD of imposing stamp duty on fees for marketing services for new investment fund unit subscriptions. According to the CJEU, promoting the subscription of investment fund units constitutes a necessary commercial step that must be considered an ancillary operation included in the operation for issuing and placing these units on the market.

These recent decisions regarding market placement fees for either investment fund units or debt instruments, particularly bonds and commercial paper, opens the door for taxpayers to request the recovery of any stamp duty paid on these fees, using the administrative and judicial procedures and considering the applicable deadlines, on the grounds that it is incompatible with Council Directive 2008/7/EC of February 12, 2008.

Municipal tax benefits: a tax competitiveness factor

António Gaspar Schwalbach and *Tiago Martins de Oliveira*

Under the Intermunicipal Entities and Local Authorities Financial Regime ("**RFALEI**") approved by Law 73/2013 of September 3, municipalities have the power to impose taxes, including the power to grant tax exemptions and benefits.

Municipal tax benefits consist of total or partial, objective or subjective exemptions granted by local authorities and intermunicipal entities from taxes and other levies to which they are entitled. Their aim is to protect important public interests with a particular impact on the local or regional economy. These benefits are approved by the municipal assembly following a proposal by the municipal council. The respective criteria and conditions of applicability for residents and companies operating in the municipality are set out in a specific regulation.

These benefits must be formulated generically and comply with the principle of equal treatment. Although they cannot be granted for more than five years, they can be renewed once for the same time period.

This type of benefit can be granted in six main areas: (i) support for families and housing; (ii) leisure, cultural and sports associations; (iii) environmental sustainability; (iv) urban rehabilitation; (v) listed properties or properties allocated to local historical, cultural or social interest entities; and (vi) economic activity in the municipality (as we will address below).

To strengthen the business environment and incentivize investment and local economic development, local authorities and intermunicipal entities may establish total or partial exemptions from taxes and other municipal levies—often associated with investment projects of municipal interest—through municipal tax benefit attribution regulations.

One commonly used benefit is the exemption from or reduction of the municipal surcharge (*derrama municipal*). This tax is set by municipalities and is capped at 1.5% on the taxable income subject to and not exempt from corporate income tax ("**CIT**"), proportional to the income generated in that geographical area by the corresponding taxable persons.

Municipalities may also grant an exemption from or a reduction of the municipal property tax ("**IMI**") rate on properties purchased by companies or individual entrepreneurs based in the municipality. This exemption or reduction is aimed at incentivizing new investment projects and promoting the development of locally important economic activities.

Under the IMI Code, municipalities can set an IMI rate of between 0.3% and 0.45% for buildings each year through a municipal assembly resolution. Municipalities' tax autonomy allows them to lower the fixed rate in certain circumstances.

Municipal tax benefits may also be granted—although less frequently—through exemptions from or reductions of municipal property transfer tax ("**IMT**") when companies purchase properties to pursue their business activities with the aim of establishing or expanding in the municipality or relocating there.

These two benefits are usually associated with the IMT rate exemption or reduction and the IMI rate being recognized for buildings purchased as part of local investment projects.

Municipal tax benefit attribution regulations can also establish a total or partial exemption from municipal rates and payments due for issuing licenses or other administrative permits for the approval and use of urban development operations, considering (i) the investment amount to be made, (ii) the net number of jobs to be created, (iii) the deadline for implementing the project, and (iv) the significance of the proposal for the municipality in question.

Sometimes, these municipal regulations also regulate the tax benefits established in the Investment Tax Code for local taxes, which are a part of the contractual tax benefits for productive investment and the investment support tax regime.

As a rule, tax benefits are granted by entering an investment contract between the municipality and the beneficiary entity, which contains the objectives the beneficiary must fulfill, the benefits granted, and the duration period. Generally, these benefits are aimed at the (i) technological modernization of the local economy, (ii) the diversification of the business environment, (iii)the retention of the population, (iv) net job creation, and (v) the qualification and competitiveness of specific sectors of activity.

As municipalities have a certain degree of autonomy to establish their own tax policies, municipal tax benefits can vary across municipalities and function as a positive tax competitiveness factor.

Therefore, for every project, investors must carry out a comprehensive review and analysis of the opportunities and requirements for potential municipal tax benefits.

Going beyond the transfer pricing regime for interest deduction

Ana Helena Farinha and *Tiago Martins de Oliveira*

As in many other jurisdictions, the CIT Code sets certain limitations on interest deduction. The most common limitations are as follows:

(i) The so-called "interest barrier rule," a limitation on the deductibility of financing costs that was introduced in 2013 and that replaced the thincapitalization regime and established that financing costs may be deductible up to €1 million or 30% of tax-adjusted EBITDA.

(ii) The transfer pricing rules, according to which interest payable between related parties may be deductible, provided the terms or conditions are substantially the same as those that would typically be agreed upon, accepted and practiced between independent entities in comparable transactions.

However, in addition to these rules (which are consistent with several EU tax regimes), there is a further limitation on interest deductibility. This limitation establishes that interest on shareholder loans that exceeds the interest rate set in an ordinance should not be deductible for CIT purposes, unless the transfer pricing regime applies.

Based on this limitation, interest payable to shareholders that do not qualify as related parties under transfer pricing rules may not be fully deductible for CIT purposes, even if the interest rate has been set under arm's length conditions.

Under transfer pricing rules, shareholders are usually considered to be related parties if their stake exceeds 20%. Therefore, interest payable to minority shareholders with a stake of less than 20% may not be fully deductible for CIT purposes.

Currently, the interest rate established in the ordinance in question is the Euribor 12-month rate plus a spread of 2% (6% in the case of small and medium-sized enterprises). This was set in 2014 and has not been updated since. Therefore, if a minority shareholder—with a stake of less than 20%—grants a loan to a Portuguese company that does not qualify as a small or medium-sized enterprise and the loan is remunerated at the current Euribor 12-month rate plus a spread of 4%, the interest on the excess of 2% should not be deductible for CIT purposes.

This rule appears to go beyond the interest barrier rule established in Anti-Tax Avoidance Directive 3 and the transfer pricing rules commonly applied in various tax systems. This rule distinguishes between third-party financing and loans granted by a shareholder with a stake of more than 20% as opposed to loans granted by a shareholder with a stake of less than 20%.

At first glance, there seem to be no anti-avoidance reasons justifying this limitation on the deductibility of interest, which is directly set by an ordinance and cannot therefore consider all the changes in the interest rate market.

Finally, given the rapid increase in interest rates recently in the financial markets, this rule may constitute a restriction on the financing of Portuguese companies through shareholders loans, which is inconsistent with other

tax systems in the EU.

Reinvestment of capital gains under the More Housing Program

Maria Inês Cotrim and *Marta Correia Gonçalves*

The law that introduced the measures of the much-publicized More Housing legislative package (published on October 6) amended the regime for reinvesting capital gains from a personal income tax ("**PIT**") perspective.

To eliminate obstacles to moving house and family mobility, the PIT Code establishes that gains from the sale of real estate intended for own and permanent housing may be exempt from taxation, provided the following conditions are cumulatively met:

a) The realization value (sales value) is reinvested in acquiring ownership of another property, land for construction or construction on that land, or in extending or improving another property exclusively for the same purpose (own and permanent housing);

b) The reinvestment is made between 24 months before and 36 months after the realization date;

c) The taxable person expresses the intention to reinvest, even if only partially, mentioning the respective amount in the tax return for the year of sale.

If the amount is reinvested in purchasing another property, the purchaser must use the purchased property as their own home or that of a household member within 12 months of the reinvestment.

Before October 2023, the law made no reference to the concept of tax residence for the purposes of this regime, nor did it establish any minimum time period for the use of the sold home as an own and permanent home.

The wording introduced by the More Housing Program now requires:

(i) that the transferred property was the owner-occupied home of the taxpayer or a household member in the 24 months before the transfer; and
(ii) proof of compliance with this requirement by having tax residence at the property.

The law also stipulates that the same taxpayer cannot have benefited from this tax exemption regime in the year the gains were obtained or in the previous three years, unless they can prove that this was due to exceptional circumstances.

These amendments limit the application of the reinvestment regime.

However, the same law introduced two measures that extend exemption from capital gains tax, more favorably for taxpayers, though on a transitional basis:

a) Suspension of the reinvestment deadline for a period of two years, effective from January 1, 2020.

b) Non-taxation of gains from the for-value transfer of land for construction or properties intended for second homes when the realization value is used, within three months, to pay off the loan for the taxpayer's own and permanent home or that of their descendants.

This last measure will alleviate the costs families have incurred with bank loans, without penalizing them in relation to the taxation of capital gains arising from the sale of second homes made between January 1, 2022, and December 31, 2024.

For additional information on the contents of this document, please contact *Cuatrecasas*.