

TAX



Newsletter

2nd Quarter 2020

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EDITORIAL

Now that the summer is here, it is time to take stock of the second quarter of the year, during which the government continued to adopt several measures in response to the COVID-19 pandemic. We have been reporting on these measures in our publications, a summary of which you can see [here](#).

After the State Budget for 2020 was approved by the end of March (doomed from the start, as it was based on the macroeconomic scenario before the pandemic), this quarter ends with the discussion in Parliament of the Supplementary State Budget for 2020.

Without losing sight of the goal of the first measures (immediate relief of treasury needs), the Supplementary State Budget for 2020 includes a number of far-reaching tax measures focused on companies' taxation. Of particular note are those aimed at enhancing the use of tax losses in the current crisis, as well as the new rules for calculating advance payments of the 2020 corporate income tax.

From a revenue perspective, the Supplementary State Budget for 2020 creates a new solidarity surcharge for the banking sector (the "Solidarity Surcharge"), adding to the existing Contribution of the Banking Sector surcharge. This inevitably raised several criticisms from the sector.

The new tax measures introduced by the Supplementary State Budget for 2020 are analyzed in one of the papers that we invite you to read in this edition of our Newsletter.

As mentioned in our last edition, by the end of January, the government presented in Parliament the Draft Law 11/XIV, transposing Directive (EU) 2018/822 of May 25 ("DAC6"), which establishes a new obligation to report operations to the Portuguese tax authorities.

The final version was eventually approved by Parliament on May 28, and it has already been

promulgated by the President of the Republic and is now pending publication in the official gazette to enter into force.

EU Member States should have transposed DAC6 into domestic law by December 31, 2019, and they were obliged to apply the new rules from July 1, 2020.

However, we should also consider the particularly demanding transitional regime for cross border mechanisms already available (not applicable exclusively to domestic mechanisms), which requires that mechanisms whose first implementation step occurred or will occur between June 25, 2018, and June 30, 2020, must be reported by August 31, 2020.

However, because of the effect the pandemic has had on the relevant actors (tax authorities, enterprises and intermediaries), the EU reached an agreement to give Member States the option to postpone, for a six-month period, the application of the new rules on the automatic exchange of tax information and reporting to the tax authorities.

As far as we are aware, the Portuguese Government is expected to follow the position of other Member States that have confirmed they will opt for the postponement, though this is still pending confirmation.

Also, worth mentioning is that, on June 26, the President of the Republic promulgated the Parliament Decree amending the corporate income tax code and transposing Council Directive (EU) 2016/1164 of July 12, 2016, regarding hybrid mismatches (anti-tax avoidance directive, commonly known as "ATAD").

The Parliament Decree, published in the official gazette (Law 24/2020, of July 6), establishes an unprecedented set of rules aimed at counteracting the effects of hybrid mismatches, which are the consequence of differences in the legal characterization of payments (financial instruments) or entities, which surface in the



interaction between the legal systems of two jurisdictions.

The effect of those mismatches is often a double deduction (i.e., deduction in both states) or a deduction of the income in one state without being included in the tax base of the other. This is an important matter that we will revisit soon.

The legislator also took this opportunity to amend article 67 paragraph 11 of the Portuguese corporate income tax code ("interest barrier rule"), which the European Commission found to be in breach of article 4 of ATAD. Portugal used the possibility granted by the directive to exempt financial undertakings from the interest limitation rules, but in a way that exceeds the scope of the exemption authorized by the directive, as it included in the scope of the exemption securitization entities, which should not be considered "financial undertakings" for the purposes of ATAD.

I now invite you to analyze the topics we selected for this quarter with the hope that the upcoming months provide new opportunities for joint reflection.

Diogo Ortigão Ramos

I. THE 2020 SUPPLEMENTARY STATE BUDGET: A SUMMARY OF THE GOVERNMENT'S (DIFFERENT) APPROACH

The new tax measures the government is implementing through the 2020 Supplementary State Budget are on the agenda of all discussions relating to the direction of Portuguese taxation in the near future.

From an early stage, it was clear that the approval of extraordinary measures to deal with the economic impact of the COVID-19 pandemic was inevitable. The effect of the pandemic that led to the state of emergency decreed by the Portuguese president on

March 18, which lasted until May 2, followed by the state of calamity, culminated in unavoidable negative economic and social consequences. During this period, the measures implemented focused on guaranteeing taxpayers' liquidity and simplifying procedures.

With the 2020 Supplementary State Budget, and without losing focus on liquidity, the Portuguese government seems so be focusing on the long-awaited economic recovery.

However, unlike in previous years, the tax measures the it has implemented do not affect individuals directly. In fact, the government has not created any personal income tax ("PIT") benefits, new PIT brackets or additional solidarity taxes to tackle public debt.

Instead, the 2020 Supplementary State Budget aims to support companies (relating to tax losses carry forward) by i) suspending the carry forward during 2020 and 2021; and ii) extending the carry forward from five to ten years, as well as raising the deduction limit from 70% to 80 % for tax losses in 2020 and 2021.

Also, because of the expected increase in corporate restructuring, the Portuguese government has put other measures in place, such as i) suspending the limit on the deduction of tax losses in the context of merger operations under the tax neutrality regime; and ii) putting a special tax regime in place for the transfer of tax losses applicable to acquirers of companies considered to be in trouble (allowing the transfer of tax losses generated by SMEs and the respective deduction in the sphere of the acquiring company in proportion to its shareholding).

The Portuguese government has also extended the payment deadlines applicable to debtors that comply with an instalment plan authorized by the Portuguese Tax and Customs Authority or the social security authorities under the terms of a recovery plan approved in insolvency proceedings, special revitalization proceedings, special proceedings for payment agreements, or agreements subject to the extrajudicial business recovery regime.



An adjustment is also foreseen for the rules of payments on account, both in terms of PIT and corporate income tax ("CIT"), in which, depending on the activity recorded, a partial or total limitation will apply to the 1st and 2nd payment on account for 2020.

Also, the special investment tax credit scheme (*Crédito Fiscal Extraordinário de Investimento* or "CFEI II") is expected to be reinstated, creating a deduction for investments made in the second half of 2020 and the first half of 2021, provided certain requirements are met, such as the obligation to maintain jobs for a three-year period.

The government has also created a new solidarity surcharge for the banking sector (the "Solidarity Surcharge"), adding to the existing Contribution of the Banking Sector surcharge. The goal of the Solidarity Surcharge is to assist the state in the public response to the current crisis, through its consignment to the Social Security Financial Stabilization Fund. To justify creating an additional surcharge for the banking sector, the government argues that it will compensate for the fact that most financial services and operations are exempt from VAT, so creating an additional surcharge for the banking sector brings its tax burden in line with that of other sectors.

As explained, unlike a generally more conservative and severe approach, the 2020 Supplementary State Budget does not concern individuals (in terms of tax benefits or tax burdens), foreseeing the recovery of the economy through consumption and support and tax benefits for companies. However, whether the announced tax measures will be sufficient to tackle the economic crisis caused by the pandemic, or whether the government will be forced to announce new tax measures that could affect individuals, remains uncertain.

Regarding the Portuguese government's justification for creating the Solidarity Surcharge for the Banking sector, we highlight two points: (i) the VAT exemption is mandatory under the VAT Directive, which also covers the insurance sector, to

which the Solidarity Surcharge does not apply; and (ii) the banking sector's activities are subject to other taxes (e.g., stamp duty).

Although the government has adopted a different approach in favor of taxpayers, a question must be raised: are these measures enough in the economic crisis we are facing?

To assess whether the Portuguese government's approach is sufficient, we will have to wait for its final results after the long-awaited recovery of the Portuguese economy.

Ana Helena Farinha
André Caetano Ferreira

II. AUTONOMOUS TAXATION – REPRESENTATION EXPENSES

On May 7, 2020, the South Administrative Central Court issued its ruling on proceedings 1374/08.0BELRS, stating its views on interpreting the concept of representation expenses.

One of the questions raised was whether the expenses borne by the taxable person for the acquisition of two football stadium business lounges to increase sales to its dealers and clients (i.e., awarding tickets for the Euro 2004 matches when meeting certain sales objectives) should be subject to autonomous taxation.

Under item 7 of article 88 of the Portuguese Corporate Income Tax Code (the "CIT Code"), representation expenses are subject to autonomous taxation. These are defined as "*the expenses borne for receptions, meals, travel, tours and shows offered in Portugal or abroad to clients, suppliers or any other entities.*"

The purpose of applying autonomous taxation to representation expenses is to encourage taxpayers to reduce expenses in an overlapping area between business and personal purpose that can be used to remunerate third parties without taxation.



This legal provision has been consolidated by legal doctrine and caselaw.

According to the perspective advocated by the Portuguese Tax and Customs Authority (the “TA”), both in administrative and judicial proceedings, *“the concept of representation expenses includes funds intended to represent a company to third parties and are often paid to managing partners, administrators, directors, managers and others.”* However, when these expenses are proven to be associated with promotional events, the TA considers them advertising expenses, which are tax-deductible and not subject to autonomous taxation.

In this case, the TA considered that, although the expenses were for promotional purposes and considered tax deductible, they were still subject to autonomous taxation by being directly subsumed in the above legal provision.

The court stated that *“representation expenses are those whose purpose is to represent a certain company where it is not located,”* concluding that *“not all expenses borne for receptions, meals, travel, tours and entertainment offered in Portugal or abroad to clients, suppliers or to other persons or entities are necessarily considered representation expenses, since the purpose of such expenses must be underlying, i.e., the representation of the company where it is not located.”*

The court found that *“if a certain cost, for travel, tours, entertainment, etc., is of promotional nature, it is not considered a representation expense, solely because of its promotional purpose.”*

Therefore, because of their promotional purpose, the expenses of taxable persons for promotional events with clients and suppliers should be excluded from the concept of representation expenses.

Although *“representation of the company where it is not located”* did not materialize, and the wording of item 7 of article 88 of the CIT Code was not discussed, it seems that the court intended to go further by acknowledging that autonomous taxation on promotional expenses is not justified when they are

borne for entities with which the taxable person has a business relationship and, as such, are clearly within its business scope.

In a nutshell, the court concluded that although certain expenses are subsumable, because of the literal nature of the legal provision, representation expenses can only be considered as such when they are incurred to represent the taxable person where it is not represented (e.g., expenses borne for potential clients), and whether these expenses are for promotional purposes still needs to be determined.

Therefore, in light of the line of reasoning of this court decision representation expenses depend on their purpose. To ensure they are accepted as tax deductible and that they are not subject to autonomous taxation, the taxable person must be able to justify these expenses and their purpose.

It must be stressed that this position of the court contrasts with the TA and the higher courts’ traditional position regarding the applicability of autonomous taxation to other type of representation expenses.

If, on one hand, there is room for arguing whether representation expenses are based on their purpose, the scenario has been different for other type of expenses, for instance those associated with passenger cars.

Indeed, expenses associated with passenger cars have in general been understood to be subject to autonomous taxation regardless of their purpose.

Although the basis for the court’s decision deserves deeper analysis, it has strengthened the final interpretation of the subjection rule, limiting it to situations where the expenses are incurred without a “reciprocal contribution” (e.g., without the promotional purpose of the expenses in the situation at hand) and with a representation purpose.

If the judgement of the Administrative Central Court is confirmed and advocated in future court decisions



in analogous cases, taxpayers that bear this type of expenses to increase sales to regular clients may eventually be released from the payment of autonomous taxation.

Ricardo Codeço
Cátia Reis Andrade

III. LEGISLATION

Ministry of Finance

Ordinance 88-A/2020, of April 6

- > It approves the filing instructions for the Monthly Wage Statements (*Declaração Mensal de Remunerações*) for 2020 and the following years.

Presidency of the Council of Ministers

Decree-Law 13/2020, of April 7

- > It amends the legal regime for electronic certification of micro, small and medium-sized companies, simplifying it and annulling certificates unduly granted due to false or inexistent facts.

Presidency of the Regional Government of the Azores

Regional Regulatory Decree 9/2020/A, of April 9

- > It establishes the legal framework for the *Casa Renovada, Casa Habitada* Program, aimed at granting financial support to renovate, repair and improve buildings for permanent housing or for rental.

Ministry of Finance and of Modernization of the State and Public Administration

Ordinance 98/2020, of April 20

- > It creates the Directorate for Taxpayer Support and Defense (*Direcção de Serviços de Apoio e Defesa do Contribuinte*), aimed at ensuring taxpayers are supported when exercising their defense rights.

Ministry of Foreign Affairs

Notice 23/2020, of May 20

- > It announces the entry into force of the Agreement between the Portuguese Republic and the Republic of Angola on Mutual Investment Promotion and Protection.

Ministry of Justice

Ordinance 121/2020, of May 22

- > It determines that the newly created administrative first instance courts' specialized chambers will begin to operate on September 1.



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Cuatrecasas has set up a Coronavirus Task Force, a multidisciplinary team that constantly analyzes the situation emerging from the COVID-19 pandemic. For additional information, please contact our taskforce by email TFcoronavirusPT@cuatrecasas.com. On our [website](#), you can read our publications or attend webinars on legal issues arising from the pandemic and the measures adopted to mitigate it. You may also find our publications in [Portuguese](#) and [Spanish](#).

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