CUATRECASAS

TAX

Newsletter

3rd Quarter 2020

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CUATRECASAS

EDITORIAL

First of all, we hope you are all in good health as we enter the final stretch of the year, which has been marked in Portugal by a significant increase in the number of new COVID-19 infections, leading the Portuguese Government to introduce this week a set of new measures to try to control the spread of the pandemic.

However, the week started with the government's presentation of the Draft State Budget for 2021, which is now entering the discussion phase until its final approval by the Portuguese Parliament, scheduled for November 26.

Against a backdrop of severe economic recession and great uncertainty regarding the evolution of the pandemic both in Portugal and abroad, the budgetary document presented is based on a macroeconomic scenario in which the government expects negative gross domestic product (GDP) growth of 8.5% in 2020 and a positive growth of 5.4% in 2021. This follows a fall in GDP of 17.2% during the first half of the year, according to data from the Bank of Portugal.

After the budget surplus reached in 2019, the government estimates a budget deficit of 7.3% in 2020 and 4.3% in 2021.

In this context, the proposal has as its Achilles' heel the absence of effective tax measures to support the financing and capitalization of companies and business investment.

The uncertain times in which we live and the social support measures that are anticipated should not make us forget the importance for the national economy of supporting businesses.

Although we will send a more detailed analysis of the main tax measures in the proposal, we would like to make a brief comment on two of these measures.

The first, which has been presented as an "IVAaucher," aims to stimulate the accommodation, culture and catering sectors. It grants "credit" equivalent to the value of the VAT borne on consumption in these sectors, which taxpayers will be able to deduct from the payment of goods and services consumed in the following quarter.

There is an urgent need for measures to support these sectors of activity, which are an important part of the Portuguese economic fabric and have been hard hit by the current crisis. However, although the "IVAaucher" seems to be a straightforward measure, its implementation and control mechanism seems to be complex, and its effectiveness and scope will likely be limited and disappointing.

The second measure, which we find particularly odd, is the introduction of a real estate transfer tax on the acquisition of 75% or more of the capital of public limited companies whose assets are mainly derived from the ownership of real estate not directly related to exercising an agricultural, industrial or commercial activity other than the purchase and sale of real estate.

Regardless of the merits of the measure, the bad timing that the government demonstrates by proposing to introduce it now is regrettable, as it affects one of the most resilient sectors with great direct and indirect contribution to the level of economic activity in the current economic context.

The government could not have chosen a worse time to send the market a new message of instability and unpredictability of the Portuguese tax system. Even more so as the tax revenue that might be collected in 2021 if the measure were to prosper will certainly be quite low.

We conclude by inviting you to analyze the matters we have selected for this quarter.

Diogo Ortigão Ramos

I. REAL ESTATE INVESTMENT FUNDS' INCOME FROM CONSTRUCTION OR REHABILITATION PROJECTS AND SALE OF REAL ESTATE

With the decision in Case 38/2017, the Portuguese tax authorities have clarified several doubts on how to interpret the current tax regime for collective investment undertakings ("CIUs") relating to income real estate investment funds receive from carrying out a buying-selling real estate activity. The decision is undoubtedly welcome.

The current tax regime for CIUs and their participants, introduced by Decree-Law 7/2015, of January 13, responded to a long-standing need to increase the competitiveness of domestic CIUs by improving their ability to attract foreign investment and their comparability within a European context mostly characterized by exit tax regimes.

Decree-Law 7/2015 significantly modified that tax regime by abandoning the previous entry tax regime applied in the sphere of the vehicle, with participants being exempt from taxation on income from their investment.

Eliminating economic double taxation of CIU investors' income is now achieved by not taxing the income at the level of the CIUs and postponing taxation until it is actually obtained by investors (exit taxation), covering real estate and securities investment companies and funds. There is also the periodic stamp duty taxation on the net asset value of CIUs.
Specifically, under the amendments that Decree-Law 7/2015 makes to article 22 of the Tax Benefits Statute ("EBF"), CIUs are subject to corporate income tax ("CIT"), with their taxable profit being determined based on the net results for the year determined under the applicable accounting rules.

However, article 22, no. 3 of the EBF states that, to determine the taxable profit, "*the income referred to in articles 5, 8 and 10 of the PIT Code will not be considered* (…)," meaning investment income, rental income and capital gains, respectively.

This exemption does not cover income from entities resident or domiciled in a jurisdiction with a clearly more favorable tax regime, or income from management commissions and other commissions that accrue in CIUs.

The decision in Case 38/2017, which was sanctioned by order of the Secretary of State for Tax Affairs ("SEAF") 107/2020-XXII, of March 9, deals with the framework applicable to income real estate investment funds obtain from carrying out construction or rehabilitation projects and selling real estate.

In short, the underlying question in this exact situation was whether income investment funds obtain from carrying on a commercial activity of buying and selling real estate should be excluded from taxation as income referred to in article 10 of the Personal Income Tax ("PIT") Code (*i.e.*, income earned from the onerous transfer of real estate) or whether it should be taxed as income referred to in article 3 (and 4) of the PIT Code, *i.e.*, as income obtained from carrying out a business activity.

The Portuguese tax authorities have confirmed the irrelevance of the inclusion of the income in the different income categories of the PIT Code and the reference made in article 22, no. 3 of the EBF aim to identify "the relevant mechanical or objective characteristics" of that income, merely alluding to the income descriptions of articles 5, 8 and 10 of the PIT Code.

In other words, the Portuguese tax authorities have confirmed that any gains real estate investment funds make from selling real estate are excluded from CIT as income referred to in article 10 of the PIT Code. This is because the provision includes gains from the onerous sale of real estate rights *in rem*, regardless of whether, under the PIT Code, this income is included in the category of wealth increases (which includes capital gains) or in the professional income category.

Although late, we welcome the reasoning of this decision and embrace its interpretation of article 22, no. 3 of the EBF.

As stated therein, this interpretation is the only one aligned with the legislator's intention to put forward an "income entry exemption and exit taxation" regime that will ensure CIU investors' income is no longer subject to economic double taxation.

Gonçalo Bastos Lopes
Tiago Gonçalves Marques

II. TAX ARBITRATION COURT DECISION 361/2019-T – SANGRIA SUBJECT TO €0/HL IABA

In its recently published Decision 361/2019-T, the Tax Arbitration Court analyzed the lawfulness of rejecting an application for a refund of tax on alcohol, alcoholic beverages and added sugar or other sweeteners ("IABA") relating to releases for consumption of the alcoholic beverage sangria, carried out between January 2017 and June 2018, for a total of €53,006.37.

The decision concerned the appropriate IABA framework for sangria, specifically whether it qualifies as "still wine" (taxed at 0% under article 72(2) of the Excise Taxes Code ("CIEC")), or whether it qualifies as "another fermented still beverage" (in which case, €10.44/hl applies under article 73(2) of the CIEC).

Strictly speaking, until the State Budget for 2017 entered into force, this discussion was non-existent, as the rate applicable to "other fermented, still and sparkling beverages" was the same as the one applicable to "still and sparkling wines" (€0). However, due to the amendment of the State Budget for 2017, a rate of €10.30/hl was established for "other fermented, still and sparkling wines," which was further increased to €10.44/hl as of 2018.

Therefore, as of 2017, the €0/hl IABA tax rate is exclusively applicable to alcoholic beverages classified as "still wines."

While the applicant argued that sangria qualified as "still wine," i.e., subject to the €0/hl rate, when it was introduced for consumption, the Competent Customs Office ("EAC") interpreted it otherwise, i.e., it considered the beverage as "other fermented still beverages," which are subject to one of the two rates above, depending on whether it was introduced in 2017 or 2018. The EAC's argument is based on the understanding that sangria, as an aromatized wine, should not be considered wine, but rather a wine-based beverage. The EAC's found that this conceptual discrepancy was enough to place sangria in the "other fermented still beverages" category.

However, the CIEC provides the following:

- **Still wine:** (i) the product must be covered by CN codes 2204 and 2205; (ii) the actual degree of alcohol must be entirely obtained from fermentation; and (iii) the degree of alcohol must be above 1.2% vol. and below 18% vol.
- **Other still fermented beverages:** (i) the product must be covered by CN codes 2204, 2205 and 2206; (ii) the beverage must not qualify as wine, beer or other fermented sparkling beverages; and (iii) the degree of alcohol must be above 1.2% vol. and below 10% vol.; alternatively, if the degree of alcohol is above 10% vol. but below 15% vol., the alcohol in the product must be entirely from fermentation.

When comparing these two fiscal categories, we are faced with overlapping situations; namely, when the degree of alcohol in a product covered by CN 2204 and 2205 is higher than 1.2% vol. but below 15% vol., and the product is entirely from fermentation, as is the case with sangria. However, the Tax Arbitration

Court states that the CIEC provides a solution to such overlap in article 66 (1) (d), which excludes wines from the notion of "other fermented still beverages."

Therefore, the Tax Arbitration Court understands that, once the legislator clearly excludes wines from "other fermented beverages," products classified as wines can no longer be considered "other fermented still beverages."

Consequently, it remains to be seen whether sangria can be considered wine for CIEC purposes.

Both the applicant and the tax authorities agreed that sangria was covered by CN 2205, and that it was proven that the product met the other requirements to classify as "still wine" (i.e., the product is entirely from fermentation and the degree of alcohol is between 1.2% and 18% vol).

In short, sangria is considered a "still wine," subject to €0 IABA under article 72 of the CIEC.

This is a positive decision for the economic operators in the sector, increasing legal certainty and as an opportunity to recover any overpaid tax amounts on similar products.

In addition, the Tax Arbitration Court's decision confirms that the tax concepts established in the CIEC are being implemented systematically, in line with the system of the Community Directive from which they are transposed.

This decision opens the door to the possibility of including products in the concept of "still wine." Businesses in the sector will be able to reevaluate the adopted procedures, which may enable them to mitigate the negative financial impacts of the COVID-19 pandemic by improving companies' cash flows.

We anticipate similar decisions in the near future and look forward to the tax authorities' reaction.

Filipe Gomes da Silva
Diogo Gonçalves Dinis

III. LEGISLATION

Parliament Law 24/2020, of July 6

- Transposing Council Directive (EU) 2016/1164 "ATAD II," establishing rules to tackle hybrid mismatches

Ministry of Finance and Infrastructure and Housing Ordinance 166/2020, of July 8

- Establishing the procedure for granting the corporate income tax (CIT) and personal income tax (PIT) exemptions applicable to rental income generated under municipal programs for affordable housing rentals

Ministry of Foreign Affairs Notice 27/2020, of July 14

- Announcing that the Portuguese Republic has deposited its instrument ratifying the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, initiating the period for its entry into force

Parliament Law 26/2020, of July 21

- Transposing Council Directive (EU) 2018/822 "DAC 6," establishing the obligation to report certain reportable domestic and cross border arrangements to the tax authorities

Presidency of the Council of Ministers Decree-Law 48/2020, of August 3

- Approving the procedures to be adopted when submitting the SAF-T (PT) accounting file

Regional Parliament of Madeira Regional Legislative Decree 12/2020/M, of August 10

- Establishing the table of PIT rates applicable to taxpayer's resident in the Autonomous Region of Madeira and establishing that the CIT rate applicable to small and medium-sized enterprises resident in the Autonomous Region of Madeira is 11.9% up to €25,000 of taxable income

Ministry of Finance
Ordinance 215/2020, of September 10

- Approving the new EC Sales List form and respective filing rules

Office of the Assistant Secretary of State and Tax Affairs
Order 8844-B/2020, of September 14

- Establishing that the tax authorities must make it possible for taxpayers to pay in instalments PIT and CIT debts up to €5,000 and up to €10,000, respectively, without having to provide a guarantee

Ministry of Finance
Ordinance 220/2020, of September 21

- Updating the currency depreciation coefficients applicable to goods and rights sold during 2020

Presidency of the Council of Ministers
Decree-Law 74/2020, of September 24

- Subjecting the supply of electricity under low consumption of electricity contracts and within certain consumption levels to value-added tax at the intermediate rate

Office of the Assistant Secretary of State and Tax Affairs
Order 9123/2020, of September 25

- Establishing the unit price of stamps for cigarettes and rolled tobacco that are exempt from excise tax on tobacco

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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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