8 May 2019

Global Tax Alert

Portugal transposes the EU ATAD into Portuguese Tax Law

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Executive summary

Law n. 32/2019, of 3 May 2019, introduced amendments to the Portuguese Tax Law in line with the European Union (EU) Anti-Tax Avoidance Directive (ATAD) provisions.

The ATAD was presented by the European Commission as part of the Anti-Tax Avoidance package in January 2016, to provide for coordinated implementation, across the EU, of a specific set of anti-tax avoidance provisions, namely, interest deduction limitation rules, controlled foreign corporation rules, hybrid mismatches rules, exit taxation rules and the general anti-abuse rule.

By means of Law n. 32/2019, Portugal transposed rules covering the elements above, with the exception of anti-hybrid mismatches provisions, which is expected to be transposed during a subsequent phase to address both ATAD 1 and ATAD 2.

This Alert summarizes the ATAD elements transposed into the Portuguese Tax Law.

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Detailed discussion

Interest limitation rule

The Portuguese Corporate Income Tax (CIT) Code already included an interest deduction limitation rule under which the deduction of net financing expenses was capped by the higher of the following amounts:

- 30% of the taxpayer's earnings before interest, tax, depreciation and amortization adjusted for tax purposes, i.e., "tax EBITDA"
- €1 million

To comply with the ATAD's text the following amendments and clarifications were made to the former provision:

- The concept of financing expenses has been amended to include: (i) any values due or allocated to the remuneration of borrowed capital, including payments under profit participating loans or amounts under alternative financing arrangements, such as Islamic finance; (ii) interest due on bonds; (iii) imputed interest on instruments such as convertible bonds, subordinated bonds and zero coupon bonds; (iv) amortization of discounts or of premiums related with financing obtained; (v) amortization of accessory costs incurred in order to obtain loans; (vi) financing expenses regarding financial leases; (vii) depreciation or amortization of financing costs obtained and capitalized in the acquisition cost of value of the assets; (viii) amounts measured by reference to a funding return under transfer pricing rules where applicable; (ix) notional interest amounts under derivative instruments or hedging arrangements related to borrowings; (x) certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance; (xi) guarantee fees for financing arrangements; and (xii) arrangement fees and similar costs related to the borrowing of funds.
- The concept of net financial expenses is defined as the financing expenses that are included in the taxable income after deduction of interest and other income of a similar nature, that is not exempt from CIT.
- The "tax EBITDA" is defined as the taxable income or tax loss that is not exempt, adjusted by the net financial expenses as well as the depreciations and amortizations that are tax deductible.

Furthermore, Portugal opted to:

- Exclude the banks, pension funds and insurance companies from this rule (already included in the previous version)
- Not include a carve-out rule based on group ratios
- Not include a provision to exclude long-term public infrastructures projects of public interest
- Provide the possibility to carry forward the net financial expenses in excess and unused interest credit during the following five years with some limitations (already included in the previous version)

Controlled foreign company rules (CFC rules)

Under the previous wording of the law, the CFC rules provide that a Portuguese resident entity, owning, directly or indirectly, at least 25% of the share capital, voting rights or rights to income or estate of an entity considered as a CFC, is subject to tax on its allocable share of the CFC's net profit or income, if not distributed.

Upon implementation of the ATAD, the rule providing that the 25% participation was reduced to 10%, if at least 50% of the capital or rights of the CFC is owned by Portuguese residents, was revoked.

Moreover, an entity with effective taxation below 50% of the taxation that would have been imposed had such entity been resident in Portugal is now considered as a CFC. Until now such qualification would arise if the nominal tax rate applicable to such entity was below 60% of the Portuguese nominal CIT rate, i.e., 12.6% (21% x 60%). Entities domiciled or resident in a blacklist jurisdiction continue to be considered CFCs, regardless of other conditions.

The income to impute to the Portuguese taxpayer will now be the taxable profit computed according to the Portuguese CIT rules (while before it corresponded to the accounting profit), with the possibility of deducting the tax losses assessed in these terms that can be carried forward for five years, under certain conditions.

The CFC rules should not apply if the revenue of the CFC entity is not comprised by more than 25% of a set of passive income and/or from relations with related parties which are specifically addressed in the law. This rule replaces an exclusion applicable if at least 75% of the revenues derived from specific activities and the activities were not carried out predominantly in relation to the Portuguese market.

Moreover, a specific provision that excluded the imputation of the income to entities resident in Portugal, subject to a special regime of taxation (case in which the imputation was carried out by the first entity above in the chain resident in Portugal, if any) was revoked. Hence, when applicable, the imputation should be made to such entities even if subject to a special regime.

In the case of sale of the shares of a CFC by a Portuguese resident entity, the disposal value should be reduced by the amount of income previously imputed in relation to such CFC entity that has not been yet deducted (upon distribution) to the taxable profit.

Finally, in line with Cadbury-Schweppes Case, the CFC rules already excluded the imputation of income in relation to subsidiaries in the EU/European Economic Area (EEA) (in the last case provided the Member State is bound to cooperation on tax matters on similar terms to the ones applicable in the EU), as long as the set up and functioning of such subsidiaries are carried out with valid economic reasons. Upon implementation of the ATAD, the exclusion is now only applicable if the entity, in addition to the aforesaid rules, carries out an economic activity of an agriculture, commercial, industrial or service nature by means of people, equipment, assets and installations.

Permanent establishments (PEs) abroad of Portuguese resident companies

According to the Portuguese CIT code, as a rule, the profits or losses of a PE set up abroad by a Portuguese resident company should be considered in the taxable profit of the head-office.

Alternatively, the Portuguese resident entity may opt to exclude those profits and losses, provided, based on the previous wording of the law, among other conditions, the PE is subject to, and not exempt from, a CIT listed in the EU Parent-Subsidiary Directive, or, if the PE is located outside of the EU, to a CIT at a minimum tax rate of 60% of the Portuguese nominal CIT rate as noted above.

The amended text introduces an additional condition, whereas this regime of exclusion of profits or losses is only available when the tax effectively paid in the jurisdiction where the PE is located is not lower than 50% of the tax that would have been paid in Portugal (with certain requirements and exceptions).

Moreover, a provision that explicitly provided that in the case of a carve out (desafetação) of assets from the PE, their fair market value should be considered as the disposal value is revoked. Furthermore, the impact of such provision should be determined, namely considering the new rules defined in the section "tax acquisition cost in special circumstances" and also a general provision of the regime of exclusion of profits and losses of a PE abroad where there is a general obligation of assessing the transactions between the head office and the PE at arm's length.

Exit taxation – Companies resident in Portugal transferring their tax residence abroad

The CIT Code foresees that the transfer abroad of the residency of a Portuguese company, without the company being liquidated, results in a taxable gain or loss equal to the difference between the market value of the assets and the tax basis of assets as of the date of the deemed closing of the activity. This rule does not apply to assets and liabilities remaining in Portugal as part of the property of a Portuguese PE of the transferor company if certain requirements are met.

The exit tax provision was amended to consider that, on a change of residency to an EU or EEA Member State, the taxpayer may no longer opt for the payment of the tax whenever the gains are (deemed) realized. In this sense, it is now possible to opt only for one of the following alternatives:

- Immediate payment of the full tax amount
- Payment of the full tax amount in equal installments during a five-year period

The deferral of the tax payment triggers late payment interest. In addition, a bank guarantee may be requested. This guarantee equals the tax due plus 25%. In addition, annual tax returns are required if the tax is deferred.

The possibility to perform the payment of the full tax amount in equal installments during a five-year period ceases to exist in the following situations:

- The assets are extinguished, transferred or are no longer allocated to the entity's activity
- The assets are subsequently transferred to a country that is not an EU Member State or EEA Member State
- The taxpayer's tax residence is subsequently transferred to a country that is not an EU Member State or EEA Member State

- The taxpayer goes bankrupt or is wound up

Specific procedures need to be followed in respect to any of the above-mentioned situations.

Tax acquisition cost in special circumstances

In the case of a carve out of assets from a PE abroad (desafetação), namely being allocated to the Portuguese head office, the respective cost of acquisition for tax purposes corresponds to the net accounting value of the asset or, if lower, the respective fair market value. With several specificities, the same principle is applied to the assets of an entity that transfers its legal seat and/or place of effective management to Portugal (i.e., becomes resident in Portugal).

If the PE is located in the EU, or the entity that transferred its legal seat and/or place of effective management to Portugal originally had its legal seat or place of effective management in the EU, it may be possible to consider as the tax acquisition value in Portugal the fair market value at the date of the transfer, provided such value was used for purposes of the assessment of the taxable income in the State of origin upon such event.

Specific rules apply to a given set of assets and liabilities.

General anti-abuse rule (GAAR)

The new wording of the GAAR as transposed to the Portuguese domestic law (in the General Tax Law and Procedure and Process Tax Code) provides that an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the objective or purpose of the applicable tax law which are not genuine considering all relevant facts and circumstances should be disregarded and the tax advantages should not be granted. For these purposes, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. Instead, the operation should be taxed in accordance with the rules that would be applicable to the substance or economic reality.

If the arrangement or the series of arrangements resulted in the non-application or reduction of final withholding tax it should be considered that the tax advantage occurs at the level of the beneficiary of the income. Nevertheless, if the taxpayer responsible for withholding (the withholding tax agent) has or should have the knowledge of such arrangement or a series of arrangements, this withholding tax agent should be liable for the amounts withheld and not delivered to the State under the general liability rules.

Compensatory interest (increased in 15%) and penalties should also be due.

The application of the new GAAR depends on a specific procedure (which includes a prior hearing of the taxpayer and a tax audit).

Entry into force and transitory regime

Law n. 32/2019 entered into force on 4 May 2019. With respect to the exit taxation provisions, a transitory rule is provided, under which the former provision is still applicable to the taxpayers that opted for the payment of the tax whenever the gains are (deemed) realized.

For additional information with respect to this Alert, please contact the following:

Ernst & Young S.A., Business Tax Advisory, Lisbon

- Luis Marques, *Country Tax Leader* luis.marques@pt.ey.com
- António Neves antonio.neves@pt.ey.com
- Joao Sousa joao.sousa@pt.ey.com
- Pedro Paiva pedro.paiva@pt.ey.com

Ernst & Young S.A., International Tax Services, Lisbon

- Paulo Mendonca, *Transfer Pricing* paulo.mendonca@pt.ey.com
- Pedro Fugas pedro.fugas@pt.ey.com

Ernst & Young S.A., People Advisory Services, Lisbon

- Anabela Silva anabela.silva@pt.ey.com

Ernst & Young S.A., Other Tax, Lisbon

- Carlos Lobo carlos.lobo@pt.ey.com

Ernst & Young S.A., Global Compliance & Reporting, Lisbon

- Rui Henriques rui.henriques@pt.ey.com

Ernst & Young LLP (United States), Portuguese Tax Desk, New York

- Tiago Rosa tiago.rosa@ey.com

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EYG no. 002225-19Gbl

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