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Global Tax Alert

Portugal amends REIT regime

Executive summary

Decree-Law no. 19/2019, dated 28 January (Decree-Law 19/2019), enacted on 1 February 2019, introduced the legal framework of the Portuguese Real Estate Investment Trust (REIT) regime, a new vehicle aimed at promoting investment and energizing the Portuguese real estate market.[1]

Tax-wise, Decree-Law 19/2019 did not address the tax regime that should apply to these new entities but only made a brief reference in the preamble, according to which REITs would benefit from the neutral tax regime established for the other real estate investment companies that are incorporated and operate in accordance with the Portuguese law.

Subsequently, the Portuguese Parliament has approved Law no. 97/2019, dated 4 September (Law 97/2019), enacted on 9 September 2019, that amends Decree-Law no. 19/2019 and introduces, among other changes, an article specifically addressing the tax regime applicable to REITs.

Detailed discussion

Changes to the REIT legal regime

Law 97/2019 has introduced several changes to the REIT legal regime, which are highlighted below:

- Real estate assets owned by REITs must be allocated to rental activities, including atypical forms of leases that include the rendering of services that are necessary for the purpose of using the real estate, nevertheless, it no longer includes the ability to establish other forms of economical use of the property, as included in the previous definition of the law.
- It is clarified that REITs may acquire shares in Portuguese companies, provided that certain conditions are met, as it was previously foreseen for companies from other European Union (EU) Member States or in a European Economic Area Member State with an exchange of information agreement that provides an exchange of information clause in similar terms as within the EU.
- The manager of the REIT must request a valuation of its assets, at least every seven years, from an independent auditor that is registered with the Portuguese Securities Market Commission.
- Each of the property rights over real estate assets, shares, and other assets foreseen in the business purpose of the REIT, must be held for at least three years, otherwise the REIT status may be lost (previously, this loss would only occur if the non-compliance occurred during a period of time and in some instances when it was accumulated with other non-compliance situations).

Tax regime applicable to REITs

Law 97/2019 establishes that the tax regime provided for the Undertaking for Collective Investment (UCIs) as established in articles 22 (tax regime applicable to income received by UCIs) and 22-A (tax regime applicable to income paid by the UCIs to their participants), both under the Tax Benefits Code, should also apply to REITs, yet with some specificities, as further detailed below.

In general terms, article 22 of the Tax Benefits Code sets forth the tax regime applicable to the income received by Portuguese UCIs incorporated and operating in accordance with the Portuguese legislation and, as a rule, this income should be subject to Corporate Income Tax (CIT) at the standard rate of 21% (being exempt from municipal and state surcharges).

However, under the terms of article 22 (3) of the Tax Benefits Code, income qualified as one of the following three categories, as defined for Personal Income Tax (PIT) purposes, is excluded from taxation: (i) investment income (e.g., dividends and interest); (ii) rental income; and (iii) capital gains (e.g., namely derived from disposal of real estate), except if this income derives from entities resident for tax purposes in a jurisdiction listed as a tax haven.

In this context, Law 97/2019 determines that the capital gains exemption established in article 22 (3) should only apply to REITs if the properties have been held for the purpose of being rented for at least three years. It should be noted that the renting concept of "rental" includes other atypical forms of renting contracts that comprise services needed for the actual use of the property. Nevertheless, the law under analysis does not define which services should be considered for this purpose which may raise some legal uncertainty.

In very broad terms and with certain conditions, under article 22-A of the Tax Benefits Code income distributed by real estate UCIs to the nonresident participants should be subject to the reduced withholding tax in Portugal at the rate of 10% and resident participants are liable to tax at general rates depending on whether they are a corporation (in this case 25%) or an individual (in this case 28%). For participants resident in jurisdictions listed as tax havens, as well as other situations set forth in article 22-A of the Tax Benefits Code, the aggravated tax rate of 35% applies.

Additionally, income arising from capital gains derived from the disposal or redemption of participation units by nonresident participants should be subject to an autonomous taxation of 10% and resident participants are liable to tax at rates depending on whether they are a corporation or an individual as detailed above. For participants resident in jurisdictions listed as tax havens, the reduced tax rate does not apply, so capital gains income should be subject to the standard rate (e.g., 25%).

For completeness it is important to note that there may also be other situations where nonresident participants may be liable to taxation both on income distributions or capital gains, at the flat rates 25% or 28%, depending on whether the participant is a corporation or an individual.

Although the intent of the legislator was to limit the use of these vehicles for lowering tax exposure on income derived from transactions which propel real estate speculation, such intent was not reflected in the wording under this provision of the Law 97/2019. Indeed, considering the wording, as it currently stands, a range of practical difficulties may exist.

Law 97/2019 also provides that in the case an entity should no longer be qualified as a REIT under the legal regime provided by Decree-Law 19/2019 since the conditions are no longer met, the tax regime set forth in articles 22 and 22-A of the Tax Benefits Code should cease to apply. In this case, the taxable profit of these entities should be determined and taxed in accordance with the general rules of the CIT Code. For this purpose, the tax period comprises the period elapsed between the date when the tax regime set forth in articles 22 and 22-A of the Tax Benefits ceases to apply and the end of the respective calendar year.

Additionally, Law 97/2019 establishes that if the tax regime set forth in articles 22 and 22-A of the Tax Benefits Code ceases to apply the income resulting from the shares held in REITs paid or made available to its shareholders and capital gains realized after that date should be taxed under the general terms of the PIT Code or the CIT Code.

Considering the recent change on the tax framework, it is possible that, contrary to other UCIs, REITs will not be liable to Stamp Duty on their net asset value.

The changes that this regime underwent demonstrate an effort by the Portuguese Parliament to clarify the tax regime that will actually be applicable to both the REITs and their participants, however, in essence, it is just a reference to a previously existing regime to which a few specifics were added. As such, both the UCIs tax regime as well as the specifics added still present a number of questions that remain unanswered and that may create uncertainty.

Endnote

1. See EY Global Tax Alert, *Portugal approves new REIT regime*, dated 18 February 2019.

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