

# Tax on companies and European fiscal integration: the Portuguese corporation tax

Vasco Branco Guimaraes\*

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## Abstract

The paper aims to review and update readers on the existing tax regime of corporate entities in Portugal by giving an explanation on the structure of the tax and its main features. It also situates the tax regime within the European trends and existing issues of integration.

**Keywords:** Corporate tax; Portugal.

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## 1. Introductory remarks and scope of the paper

The IRC (Imposto sobre o Rendimento das Pessoas Colectivas) was created in 1989<sup>1</sup> following a determination existing since 1976 in the Constitution of the Portuguese Republic.<sup>2</sup>

Changes and updates were incorporated especially through Law n.º 30-G/2000, enacted on 29<sup>th</sup> of December and more recently by Law 2/2014, enacted on 16 January, and transcription of Directive 2013/34/EU, 26<sup>th</sup> of June and Directive n.º 2014/86/UE, from 8th of July, that were incorporated in 2014 and 2016.

As it is widely known Portugal went through an adjustment procedure IMF style from 2011 until 2017 with very drastic and IMF inspired and tailored measures aiming to control the excess of public spending and budget deficit as well as balance of payments persisting deficit.

The measures taken were those of IMF practice and inspiration because Europe and in particular members of the EURO did not have mechanisms able to cope with this kind of situation. On the other side the IMF mechanisms were not created and are not designed to be applied to members of a common currency union.

It was in that context that a corporation tax reform was proposed and discussed as soon as the first three years period of the adjustment procedure were passed and the foreign advisers and keepers of the adjustment program had no longer a decisive role in the shaping of the fiscal and tax policies of the Portuguese Republic.

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\* Instituto de Direito Economico Financeiro e Fiscal (Portugal); ✉ [vbrguimaraes@net.sapo.pt](mailto:vbrguimaraes@net.sapo.pt)

1. Decreto-Lei n.º 442-B/88, de 30 de Novembro that entered in force on the 1st of January 1989.
2. Article 104.º CRP, n.º 2: «The taxation of enterprises is made fundamentally on its effective revenue».

## 2. Taxable income of corporations and business entities

In Portuguese Corporation tax Code taxable income is defined as any accrual obtained during the tax year including capital gains and other undefined gains that are measured by the difference between the value of all assets belonging to the taxable person in the beginning and the end of the tax year.

- Taxable income includes :
  - i. The revenue resulting from sales and delivery of services and any other type of remuneration of a commercial, industrial, fishery, agricultural or service activity including financial, revenue from intellectual propriety, scientific or technical services, fair value gains on financial instruments, indemnities, subsidies, capital gains, etc.
  - ii. Positive variations of capital not reflected in the accounts of the taxpayer.
  - iii. The positive difference between the amount perceived by the partners on reduction of capital and the amount paid on subscription of the equity of the company or partnership.
- Following a long quarrel about the scope of eligible costs the 2014 tax reform defined as costs the «*expenses made to obtain or ensure the tax revenue*» in article 23.<sup>o</sup> and gave examples of a number of eligible costs and in article 23-A defined the costs that are not eligible to determine the tax base that include: paid taxes, illicit or non documented expenses, penalties and connected interests, expenses that exceed ratios defined in legislation enacted with anti avoidance purposes, etc.

### 2.1. The formula for the determination of taxable income is:

Net result of the exercise  
 +  
 -  
 Patrimonial variations  
 =  
 Net Final Equity – Net Initial Equity  
 +  
 -  
 Fiscal corrections  
 =  
 Taxable income/Fiscal loss

- Mergers and acquisitions follow the European Directive that is partially quoted (*ipsis verbis*) in the Portuguese law (articles 73.<sup>o</sup> to 75.<sup>o</sup>-A of CIRC).<sup>3</sup>
- Capital gains are included and added on the tax base and therefore taxable as any other type of income, if any.

## 3. Treatment of dividends.

The tax treatment of dividends suffered a major change because the 2014 tax reform included the *participation exemption* criteria in the distribution of dividends.

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3. Code of Taxation of Corporations – IRC.

Article 14.<sup>o</sup> of CIRC gives an exemption to exported profits and reserves and articles 51.<sup>o</sup> to 51.<sup>o</sup> D do not take in consideration in the determination of profitable income the imported profits and reserves.

The discussions that took place before the enactment of the law justified the measure with the following founding arguments: i) deepening of the principle of territoriality; ii) increase of the competitiveness; iii) improvement of efficiency through the prevention of substitution behaviours such as creation of foreign companies as a way to obtain more favourable fiscal regimes or application of double taxation treaties.

The Portuguese tax regime does not tax exported profits or reserves and imported profits or reserves as long as:

- a. The tax payer detains equal or more than 10% of capital or voting rights owned directly or indirectly of the entity who distributes the dividends or reserves;
- b. The participation has been detained for more than 24 months or ensure that that period will be respected at the date of distribution;
- c. The tax payer does not benefit from a fiscal transparent tax regime;
- d. The entity who distributes the dividends or reserves is subject and not exempted from companies tax or similar as described in article 2.<sup>o</sup> of Directive 2011/96/UE from the Council, 30th of November and the supported rate is not inferior to 13,80%;
- e. That the entity who distributes the profits or reserves is not domiciled in a tax haven as defined by an act of the Ministry of Finances.

The condition previewed in d) above can be dismissed if the entity who distributes the profits or reserves actually performs its economic activity in such a territory and the company was not created for purely tax planning reasons. The distributed profits or reserves must not be a deductible expense in the country of distribution.

Some criteria exposed above apply to permanent establishments and subsidiaries.

#### **4. Directive n.<sup>o</sup> 2014/86/UE, from the Council, 8<sup>th</sup> of July**

Following the Directive n.<sup>o</sup> 2014/86/UE, from the Council, 8<sup>th</sup> of July, the text and substance of the law reflects the existing state of the art of the Parents Directive and subsequent Jurisprudence of the ECJ on the matter.

#### **5. Exit taxes**

There is no exit tax in Portugal and controlled foreign companies benefit from the status described above.

#### **6. Preliminary balance of the enacted reform**

The overall legitimacy for the enactment of the tax reforms of 2014 can be measured in two perspectives: i) the results; ii) the business environment and litigation.

As for the economic results there was an increase on IRC tax revenue from 4 519 millions Euro in 2014 to 5 229 in 2016 to 5.751,7 in 2017 (last year available).

So far, no major litigation has arisen from the new legislation and the legal solutions that were chosen pacified most of the judicial conflicts that previously existed and are yet to be resolved in the Courts.

It seems therefore, that the solutions that the Portuguese legislator choosed — taking notice of the European Directives and Jurisprudence and the needs of a small economy that is very open and basically exposed to international evolution — were adequate.

It is a common belief that the existing regime is non discriminative, reduces the difference of treatment between residents and non residents and reduces the amount of conflicts that existed previously.

No «aide d'Etat» can be found in the solutions that exist in the taxation of profits and reserves and it's distribution in Portuguese law.

## 7. Relations with existing legislation and trends in the EU

The taxation of profits made by companies has two major fronts that a reform needs to address:

- i) the internal regime and the nature, characteristics and type of capitalization, degree of development and natural and acquired resources of the economy of the country;
- ii) The international relations and obligations that the country has and must respect. The Portuguese tax reform of corporation taxation was deliberately designed to respect both conscious of the dangers and challenges that a very open and not internally capitalized economy like the Portuguese one has.

## 8. Conclusions

The success and quality of a tax reform should be made on the evaluation of the technical solutions and applicability of the same either in an internal perspective or in the respect for the external aspects of the obligations, positions and general environment were the economy interacts.

In the quest to find a good guide to evaluate the tax reforms in the countries that are part of the European Union it is our belief that any evaluation should use the respect for the basic principles and liberties that are in the founding Treaties. If a technical solution collides or does not respect one of these it is correct to assume that the solution found needs to be worked until a better solution is found.

If the solution found for the tax reform respects the four liberties and respects the law and the interpretation made by the ECJ we can assume that is correct and long lasting.

We can also assume that the possible negative side of the solutions found — when applied — can and must be counteracted by ways of institutional measures and European mechanisms that will ensure that the use and practice of the Liberties of the Treaties does not conduct any Member State to poverty or erroneous use of its resources and capability.

To state that the European Union is a place of partnership and solidarity it is not just a slogan. We must always find a way to ensure that optimization of the resources and sustainability are compatible with growth and distribution of wealth.

This is probably the greatest contribute Europe as a project can give to the world. We like to think that the existing Portuguese solution for Corporate Tax contributes to this purpose.

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**Vasco Branco Guimaraes:** Instituto de Direito Economico Financeiro e Fiscal (Portugal)

✉ [vbrguimaraes@net.sapo.pt](mailto:vbrguimaraes@net.sapo.pt)

Docente do Curso de pós graduação avançado na FDL/IDEFF (2006/07). Professor convidado no Curso de Mestrado de Direito tributário europeu de Bolonha (2001/02), e da ESSF em Bruxelas (2003/07). Coordenador da pós graduação em integração económica e direito internacional fiscal na ESAF – Brasília, feita em colaboração entre a Fundação Getúlio Vargas e a Faculdade de Direito da Universidade de Muenster (2004/06). Professor Adjunto do ISCAL – Instituto Superior de Contabilidade e Administração – IPL/UL (2007/08).