Top 10 Portugal Budget Takes 2023

October 2022

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On the 10th of October, the Portuguese Government presented the Budget Bill for 2023 to the Portuguese Parliament. The Bill is now under analysis and will be subject to discussion and submitted to approval in the upcoming weeks.

Garrigues Portugal Tax Team will share its views on the most critical 10 measures in a series. One concise review for each highlighted measure with a brief commentary in the end covering what we believe are the main take aways of this year's budget in Portugal. In case you missed it, this document will bring to you a consolidated version of our Garrigues Takes at the end of the series.

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Take #1 – New rules for the taxation of crypto assets proposed

Budget Bill for 2023 proposes the inclusion, for the first time, of specific rules aimed at clarifying the taxation of income derived from crypto assets:

- **Crypto assets defined** – *"Any digital representation of value or rights that can be transferred or stored electronically using distributed ledger technology or similar"*
- **Mining & staking income** – Taxable as category B income and subject to the progressive tax brackets schedule.
- **Conversion gains** – In the case of crypto assets which are not securities, gains from crypto to crypto and crypto to fiat conversions may be exempt provided that the assets have been held for a minimum period of 365 days; otherwise a flat rate of 28% could apply.
- **Crypto services** – Fees charged by crypto services' suppliers or intermediaries subject Stamp Duty at a 4%.
- **Reporting** – Entities, with or without legal personality, or individuals that supply custody and administration services in relation to crypto assets on behalf of third parties or that manage one or more crypto assets negotiation platforms, must report to the Portuguese tax authorities, by the end of January of each year, on a taxpayer by taxpayer basis, all the transactions involving crypto assets carried out with their intervention, according to an official form to be published.
- **Garrigues Take** – These new rules are a step forward to clarify the tax treatment of certain crypto transactions. There are, however, certain potential taxable events as well as definitions (i.e. crypto asset platform) that may require further clarification. Unfortunately, the proposal has not been subject to public discussion and no policy or impact studies have been published. The law seems to have met the expectations halfway although the creation of a more favorable regime compared to other investment property may require further discussion and may not be necessarily aligned with social consensus (always a door open for future legislative instability). Reporting, control and disclosure, notably in the European context (DAC 8), promises to be the next challenge to both taxpayers and national authorities.

Take #2 – Loss-carry forward rules: a new era?

Budget bill for 2023 proposes to change significantly the rules (and the approach) applicable to the carry forward of tax losses.

- The existing time limit to the carry forward of losses (5 years, with a 12-year period applying to SMEs) would no longer apply.
- Carryforward of losses is not admitted when taxable profit is assessed using indirect methods (and not based on accounting), but its utilization is not prevented in subsequent years.
- The existing limit to the annual deductibility of losses (70% of taxable profit) would be reduced to 65%.
- Anti-loss-trafficking rules, which, in general, determine the forfeiture of loss carry forwards in certain situations that imply change of control of a target company, will only apply if a relevant transaction had tax evasion as its main purpose or one of its main purposes (principal purposes test or "PPT"), a requisite which is verified whenever a transaction is not undertaken for valid economic reasons.
- Ministerial authorization, including upon the election to keep the historic tax losses of an RETGS Group either when the dominant company changes or when a dominant company of an RETGS acquires the dominant company of another RETSGS, is no longer required.
- The new rules apply to the carry forward of losses in FY's commencing on or after January 1, 2023, but with respect to previous-years' losses which are still opened under current rules.

Garrigues Take: the Budget bill is a step forward in the sense that (i) it is bound to align the Portuguese CIT with recent developments in the EU space (where there are already 14 jurisdictions where no time limit applies) and should significantly simplify the applicable rules, notably when the group relief mechanism (RETGS) applies. Its immediate applicability to pre-2023 losses may also bear a relevant impact in the composition of the balance sheet of the Portuguese companies, if and to the extent this measure fuels the recognition of DTAs that would not, otherwise, be recognized by virtue of the existing tax limitations. All-in-all, this proposal could improve the perception of Portugal as a non-investment friendly tax jurisdiction (although the quantitative limitation is still lower compared to a significant number of EU countries) and effectively extend the possibility to utilize losses in the case of companies doing business in industries and sectors where the investment required is heavy and front-loaded.

Take #3 – Addressing debt bias: fast forward DEBRA?

The Budget Bill 2023 replaces a number of existing incentives (i.e. a notional deduction for share capital and deduction for retained and reinvested profits) for legislation that somehow accelerates the entry into effect of the EU Debt-equity bias reduction allowance directive (also known as "DEBRA").

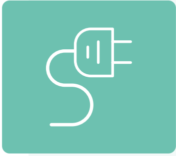
- A deduction determined as 4.5% (5% in the case of SMEs) of the annual eligible net equity increases of a Portuguese-resident entity is granted for 10 years, subject, however, to the greatest of the following limits: EUR 2 million; 30% of the EBITDA corrected for tax purposes
- Eligible equity increases include cash contributions to the formation or increase of an entity's share capital, in kind contributions to share capital resulting from the conversion of credits, share premium, retained earnings, including those utilized to increase equity reserves or share capital. Eligible net equity increases encompass the eligible equity increases after the deduction of the amounts, in cash or in kind, refunded to the shareholders in the form of share capital compensation or reduction as well as distribution of the corporate net assets occurred in the same 10-year period.
- When the deduction exceeds the 30% EBITDA limit, a carry forward period of 5 years should apply.
- The regime does not apply to entities qualifying as credit institutions, financial companies or other entities legally assimilated to credit institutions and financial companies, entities that do not have their accounting organized according to the applicable accounting standards, entities determining its profits based on indirect methods (and not on accounting) and entities that cannot obtain a certificate of compliance with their tax obligations and social contributions issued by the respective competent authorities.
- The proposal includes a specific anti-abuse rule (SAAR) to deal with potential cascading deductions in the context of direct participations with no minimum percentage threshold used.

Garrigues Take: The new regime features and partially anticipates the transposition of the DEBRA Directive, in response to a nouvelle situation of economic hardship to be confirmed in 2023, although with certain relevant nuances worth noting. It resorts to a static 4.5% notional rate which differs from (and is hard to reconcile with) DEBRA which uses the 10-year risk-free interest rate for the relevance currency increased by a risk premium of 1% (1.5% in the case of SMEs). No reference is found with respect to the utilization of an annual unused allowance (which under DEBRA should have no time limitation). The SAAR found in the budget bill is also hard to reconcile with the principles and scope of the SAAR provided in DEBRA directive (which establishes limitations to the deduction based on a wider concept of "associated enterprise" and provides indirect and constructive ownership rules). DEBRA's additional restriction to interest deductibility is also not included in the budget bill. Subject to a case-by-case analysis, this new regime is designed as a stronger incentive to capitalization. It is also a rare anticipation of Portugal to the transposition of EU Directives in the field of direct taxation. From a legislative perspective, considering the timeline for the full implementation of DEBRA, the differences identified as well as the potential binding effect of this incentive (with its potential although not publicly discussed fiscal impacts), it is not hard to anticipate future amendments (if not litigation, in case a proper and timely transposition is not put in place).

Take #4 – Inflation is the new tax?

- The 2023 Budget bill proposes an overarching update by 5.1% of each of the 9 income brackets that compose the progressive structure of the Personal Income Tax rate, whereas the marginal rate applicable to the second bracket is reduced by 2 p.p., from 23% to 21%.
- No similar update for the inflation is proposed to any of the below-the-line deductions nor to the two additional brackets applicable to the additional rate of solidarity.

Garrigues Take: High inflation was viewed by many as one of the main challenges of the Portuguese budget for 2023. The Government justifies this update as a measure to align the weight of wages in the GDP with pre-crisis values. With an estimated inflation rate of 7.4%, for 2022, and of 4%, for 2023, this update of 5.1% is insufficient to help coping with the aggregated effect of high inflation on the average available income. Moreover, and assuming that the official estimates materialize, the limited scope of this update (i.e. the fact that it has not been extended to other mechanisms relevant for the determination of the PIT due) is hard to reconcile with the abovementioned policy goals, as an uncovered gap of 6.3% of the aggregated effect remains unresolved.



Take #5 – Democratize the energetic transition?

- The budget proposal excludes from PIT, up to a limit of €1,000, the annual income resulting from the following activities: a) Transaction of surplus energy produced for self-consumption from renewable energy sources, by production units for self-consumption, up to a limit of **1 MW** of the respective installed power; b) Transaction of energy produced in small production units from renewable energy sources, up to a limit of **1 MW** of the respective installed power.

Garrigues Take: The current energy crisis, has highlighted the need to reduce the European Union's (EU) dependence on fossil fuels and to diversify and secure its energy supply, focusing on greener alternatives - such as renewable energies. At the same time, the EU wants to lead the green transition to tackle the climate crisis. Forecasting and promoting a previous public discussion are crucial tools to design effective tax incentives. Amid other considerations, to avoid spending public resources ineffectively (the Government projects an estimated tax expenditure cost of € 5 million and an undetermined number of taxpayers engaged), it is important to understand if a given measure is actually capable of motivating behavioral change, project the tipping point that convinces the targeted taxpayers to adopt the desired behavior and tackle undesirable free-riding effects. Without a complete impact study and appropriate forecast it is hard to tell if this measure will effectively contribute to democratize the so-called green transition.

Take #6 – CIT reduced rate extended. Is there a case for CIT as an equity-promoting tax?

- The draft of the State Budget for 2023 proposes to **extend** the application of the 17% rate to companies qualified as **Small Mid Cap** (i.e. with less than 500 employees), and determines that such rate should apply to the first **€50,000 of taxable income** (instead of € 25,000).

Garrigues Take: The CIT system, originally designed as a proportional tax, has exacerbated its progressivity over time, by virtue of not only the application of certain reduced rates (with a wider or narrower scope of application and some fluctuation, also typical in the Portuguese tax system), but also as the result of the State surtax, that, today, uses a complex structure of three brackets to differentiate taxpayers in different intervals of income. While it is relatively established in economic literature that the CIT is not the most well suited tax to implement equity-driven or redistributive policies, the economic effect of a 4% rate reduction that applies to the first €50.000 of taxable income has not been demonstrated (or at least publicly discussed) through adequate modelling and forecasting or ex ante and ex post impact studies. In addition, these type of differentiation between taxpayers increases control and compliance costs and contributes to the general perception of the Portuguese CIT as complex and inefficient.

Take #7 – Incentive to the increase of average salaries and to the collective bargaining of salaries: a hand full of very little?

- The annual increase of qualifying expenses with employee's compensation according to a "dynamic" collective bargaining agreement, i.e. a collective bargaining agreement executed or renewed within the previous three years, should be allowed in 150% of its respective amount as a CIT deductible expense, subject to the following conditions and limitations:
    - Qualifying expenses for purposes of this incentive means fixed salary and social security contributions borne by the same entity and only with respect to employees with a positive annual variation of at least 5.1% and whose salary is higher than the minimum monthly guaranteed salary, as it is provided in Portuguese law.
    - Taxpayers that registered a positive variation between their best-paid and their worse-paid employee (leque salarial) cannot benefit for this incentive;
- The maximum amount of qualifying expenses eligible for this incentive is capped to 4 times the amount of the minimum monthly guaranteed salary.
- Qualifying expenses with respect to family members of the employer (in the case of individual businesses), board members and employees holding directly or indirectly an interest equal to or greater than 50% of the entity's vote or capital are also excluded.
- This incentive will apply only until December 31, 2026.

Garrigues Take: This measure targets taxpayers that actively promote policies that increase the average pay of their employees. Furthermore it is an incentive to the negotiation and execution of collective bargaining agreements. It should be noted that these instruments, as their designation suggests, result from a negotiation between the participating parties that are binding only and primarily benefit such parties. Despite the possibility to extend the dispositive content of such agreements via an Executive Ordinance, considering the reality of the Portuguese labor market, there are certainly relevant gaps, i.e., taxpayers and sectors that do not and will not benefit from this incentive. First, collective bargaining agreements are more common in larger enterprises and less pervasive among SME's. Second, there are several sectors which, still today, do not benefit from these type of instruments. Third, there are citizens and companies that chose not to negotiate collective bargaining agreements nor to become members of unions or associations that are the typical parties to such agreements. From a different perspective: it is not established that this type of incentive to collective bargaining has a material effect in the economic output, employment levels or even as a stimulus to the increase of the average salary. Moreover the proposed measure showcases a high-level of complexity which, we anticipate, will require additional urgent clarification or, otherwise, it may generate future litigation. The specific mechanic limitations imposed, its limited time frame of application, and, especially if the incentive is not excluded from the general limitation to the binding effect of tax incentives, should also reduce the interest of this incentive.

Take #8 – Energy and agriculture extraordinary tax support

- Excess eligible costs with natural gas and electricity, defined as the increase of eligible costs in FY 22 vis-à-vis the costs incurred in FY 2021 (deducted of any amounts or subsidies received under Decree-law 30-B/2022, of April 18) incurred by Portuguese resident entities, non-resident taxpayers with a permanent establishment in Portugal, as well as by PIT taxpayers that derive business income (Category B) and are taxable under the financial accounting method, will be allowed as CIT deductible costs in FY 2022 for 120% of their respective amounts. This special deduction applies in taxable years starting on or after January 1, 2022.
- This benefit cannot be cumulated with other incentives, of any nature, regarding the same eligible expenses and losses.
- Likewise, In relation to FY 2022 and FY 2023, expenses incurred in the acquisition of certain agricultural goods may will be allowed as CIT deductible costs for 140% of their respective amounts.

Garrigues Take: These tax incentives are intended to target the intermediary consumption of certain basic goods, strongly affected by the inflation as a result of certain external events such as the Russian war on Ukraine, and which are crucial for a large number of sectors of the Portuguese economy. These measures, albeit positive, to the extent they lighten the burden associated to the consumption of these goods and have an indirect wide-reach across different sectors, are, however, limited in their scope as well as on their economic effect and, for that reason, it is likely that they may not have a significant impact. Moreover, in the particular case of the electricity, the intermediary consumer is only a part of a larger problem which, from a tax policy perspective, and considering the Portuguese tax spectrum, involves the distortionary effects associated with the exceptional contribution on the energy sector, whose burden is shifted precisely to intermediary and end-consumers, as well as the generation of economic rents. Hence, a holistic approach, rather than a piecemeal regulation of the problem, would have been preferable. Finally, on a more technical note, it is, at least, debatable that the Budget law is the right legal instrument to regulate taxable events which will have entirely occurred in a taxable year that finishes before its entering into force.

Take #9 – PIT incentive to young workers

- The Budget Bill for 2023 boosts t**he partial Personal Income Tax exemption for Younger workers** that derive employment and business income and which had been created in 2022. The newly proposed limits are as follows: (i) 50% in the first year with the limit of 12.5 times the value of the IAS (ii) 40% in the second year with the limit of 10 times the value of the IAS, (iii) 30% in the third and fourth years with the limit of 7.5 times the value of the IAS and (iv) 20% in the last year with the limit of 5 times the value of the IAS. Th value of the IAS for 2023 should be EUR 478,70.

Garrigues Take: The increase in the percentage of exempt income as well as the new caps proposed intend to bring this incentive to a larger group of young and highly-qualified workers. The purpose is apparently to help creating conditions to stimulate the beneficiaries' independent participation in the economy and simultaneously help curbing the so-called Portuguese brain drain. While the intention is obviously commendable, it is hard to commensurate the binding effects of these types of measure, again, in light of the lack of appropriate forecasting and modelling and, notably, considering the caps imposed. Also, taking into account a social reality where, not uncommonly, young workers still live with their families it is worth noting that this incentive is attributed irrespectively of any social or ability to pay consideration of the beneficiaries and is not structured upon any sort of conditionality (for instance entering into a lease agreement or the adoption of a specific behavior). It is further limited to young workers whose first work experience occurred in or after 2022, another feature that is hard to reconcile with the welfare-promoting profile of this incentive.

Take #10 – Incentivize the green transition or seize the moment to increase tax revenues?

- The State Budget for 2023 proposes a reduction of the **autonomous taxation rates applicable on the acquisition of plug-in hybrid and GNV-powered passenger cars**, which, will now be subject to the same rates, i.e. 2.5%, 7.5% and 15%, depending on the acquisition cost (respectively, lower than €27,500, between €27,500 and lower than €35,000 and higher than €35.000).
- In addition, a new rate 10% rate will apply to the acquisition of v**ehicles powered exclusively by electric energy** with a purchase price higher than €62,500 or more.
- The general 10% rate increase applicable to all expenditure items subject to autonomous taxation incurred in loss-making taxable years will not apply in the taxable years starting on or after 2022 and 2023, although subject to the following conditions: (i) the taxpayer obtained taxable profits in one of the three preceding tax periods and has timely fulfilled its tax reporting obligations in the two preceding periods; or (ii) the taxpayer started its activity during 2022 or 2023 or in any of the two preceding years.

Garrigues Take: Without entering the policy discussion around the rationale and justifiability of autonomous (penalty) taxation, it is possible to read the mind of the legislator: streamline and incentivize (or impose a lighter penalty) the acquisition of the more affordable vehicles powered by green energy sources and simultaneously seize the moment to increase taxes levied on the acquisition of expensive electric vehicles. It is important to remember that the market price of vehicles in Portugal is internationally high, also as a result of an unattractive consumption tax framework. This remark is important for an unbiased judgment of the € thresholds imposed to differentiate the autonomous tax rates applicable to the acquisition of vehicles. After all "expensive" may have a different translation in other markets… Also, other than for the goal of increasing tax revenues, this does not seem to be a good timing to submit electric vehicles to autonomous taxation, knowing that these are in high demand, despite the output shortages and that this new rate could reduce the interest associated to transitioning to green energy-powered vehicles. The suspension of the additional rate of 10% applicable to loss-making companies during the pandemic as well to companies that are starting or have started their activity makes sense (again, if one does not even enter the discussion around why have enacted and maintain this autonomous – penalty – taxation).

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