# TAX INFORMATION

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# THE ECONOMIC DOUBLE TAXATION OF DISTRIBUTED PROFITS IN PORTUGAL

## SEAF ORDER 98/2011-XIX OF 28 OCTOBER

The 2011 State Budget Law introduced relevant changes to the rules for elimination of economic double taxation of distributed profits in terms of corporate income tax, better known in Portugal by its initials, IRC. These changes extend the requirement that the income in question must be from profits that are subject to "effective taxation" to cover Portuguese holding companies (*sociedades gestoras de participações sociais* or SGPS).

This requirement for "effective taxation" had already been introduced by a change included in the 2007 State Budget Law. At that time it was justified as an anti-abuse measure to avoid the application of the exemption method in the system of economic double taxation of distributed profits resulting in the double non-taxation of such income.

However, and contrary to what would be desirable, at no time did the legislator make clear what it understood as "effective taxation" of the profits in question. Besides the uncertainty and lack of security that always flow from an undefined concept, this also created a (huge) expectation of clarification on the part of Portuguese economic groups. They were afraid that the tax authorities would adopt an excessively narrow interpretation of the concept under which this taxation would have to correspond to the application of a "(minimum) rate" or to the payment of a "(minimum) amount" of tax. Furthermore, it was also not clear if this would have to be paid by every company in the chain of holdings in question. This could be reason enough to restructure these economic groups, particularly after the changes taking effect as from 1 January 2011 and for the economic groups that involve SGPS holding companies.

For this reason, the issue and publication of SEAF Order 98/2011-XIX of 28 October containing the understanding of the Secretary of State for Tax Affairs (*Secretário de Estado dos Assuntos Fiscais* or SEAF) on the concept of "effective taxation" for the purposes of the application of the rules on elimination of economic double taxation of distributed profits for corporate income tax (IRC) takes on great relevance. This is because the understanding set out in this Order is binding on the tax authorities.

Under the said Order, which was made as a consequence of Opinion 26/2011 of the Centre for Tax Studies (the content of which is still unknown), the SEAF came to clear up some of the doubts around the meaning and scope of the requirement for "effective taxation".

The SEAF considers that the requirement for "effective taxation" should be deemed met when the profits in question are subject to corporate income tax (IRC) or to an identical or comparable tax, and do not benefit

from any exclusion or exemption. It is enough for this to occur in the sphere of one of the entities that make up the chain of holdings, whether this is in the sphere of the entity that distributed them or in the sphere of its subsidiary. To this extent, the understanding that has been presented goes in an opposite direction to the interpretation that the economic groups most feared and which would immediately hinder the use of intermediary companies, specifically SGPS holding companies, in the corporate chain and which would certainly also imply new business restructuring.

As to the other problem that was also raised - the possible need to set a minimum amount or rate of tax to be settled or paid - the Order in question falls short of what would be desirable as it limits itself to making it clear that there is no minimum level of taxation. It leaves open the question of whether or not this means that, in practice, "effective taxation" extends to situations in which the tax paid is "zero" (because, for example, there are tax losses), or even to situations of autonomous taxation.

However, it will be necessary to clarify this last issue. Otherwise, we may see abusive situations in which, in practice, double taxation situations occur for the income in question. This would seem to go against the very anti-abuse idea that underlies the requirement for "effective taxation" of these profits.

The strengthening of tax neutrality in corporate organisation is, therefore, positive as it operates, in the exemption method, to eliminate the successive taxation of the same income in the sphere of all the companies in the same economic group. It also ensures competitiveness in the Portuguese tax system in this area.

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