Draft Supplementary Budget: Tax Measures

The COVID-19 pandemic effects on the Portuguese economy imposed the implementation of exceptional and urgent measures. Following the approval of the Economic and Social Stabilization Programme last week, the Government approved the draft Supplementary Budget. In this newsletter we described the main tax measures proposed by the Government.

The draft Supplementary Budget contemplates important tax incentives, including an exceptional investment tax credit and incentives for SME mergers and acquisitions.

It also tax measures to help companies' treasury, including limitations on advance payments.

1. Exceptional investment tax credit

Companies which invest in fixed tangible assets, biological asses and intangible assets between 1 July 2020 and 30 June 2021 will get a tax relief in an amount equal to 20% of the investment (with a limit of €5 million). The annual deduction is limited to 70% of the CIT.

Companies that benefit from this tax relief may not terminate employment contracts by way of collective dismissal or job extinction in the following three years.

2. M&A tax incentives

2.1 Mergers

SMEs that absorb other SMES by merger in 2020 will not be subject to the limitation on tax losses deduction which takes in consideration the proportion of the assets of the merged companies for a period of three years.

This rule will apply to mergers of SMEs that (i) have been operating for more than 12 months, (ii) do not result from a demerger which occurred in the previous three years, (iii) whose activity is substantially identical and (iv) which are not bound by special relationships.

Companies that benefit from this incentive cannot distribute dividends in the following three years.

The merged companies will be exempt from State tax surcharges during the first three years.

2.2 Acquisitions

Companies that acquire shareholdings in SMEs "in difficulty" until 31 December 2020 will be entitled to deduct the tax losses generated by such SMEs. The eligibility of the SMEs will be assessed under the Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty.

The deduction will be pro rata to the portion of the share capital acquired as follows:

- The amount of losses to be deducted in each period may not exceed 50% of the taxable profit of the acquiring entity, subject to the limit applicable to the deduction of losses in each year;
- The percentage of the stake to calculate the total amount of losses to be deducted by the acquiring entity will be based on the average percentage in each period.

The special rules will only be applicable if the acquired entity does not terminate employment agreements by way of collective dismissal or job extinction and distribute dividends in the following three years.

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3. Tax losses carryforward

Tax losses generated in 2020 and 2021 may be carried forward in the following 10 years instead of the current 5-year period. SMEs will continue to benefit from a 12-year period.

Companies will also be able to deduct up to 80% (instead of the 70% threshold) the tax losses generated in 2020 and 2021.

In addition, the deadline for deducting tax losses generated before 2020 will be suspended in 2020 and 2021.

4. Limitations on advance payments

Following the extension of the first advance payments of the Personal Income Tax ("**PIT**") and Corporate Income Tax ("**CIT**") to August 2020, self-employed workers and companies will benefit from an exceptional limitation on advance payments.

Self-employed workers will be able to settle the total amount of the advance payments up to the deadline of the third payment, on 20 December, without any penalty.

Companies may be exempted from advance payments, in part or in full, as follows:

- Companies whose monthly invoicing average dropped at least 20% in the first six months of the year (comparing to the previous year) will benefit from an exemption of up to 50% in the first and second advance payments for the 2020 tax period;
- Companies whose monthly invoicing average dropped at least 40% (comparing to the previous year), or in case of companies in the accommodation, catering and similar sectors, will benefit from a total exemption from the first and second advance payments.

Lastly, companies which are partially exempted will be able to settle advance payments up to the deadline for the third advance payment.

5. Tax and social security payments by instalments

Tax and social security debts recorded between 9 March and 30 June 2020 may be added to the debt payment plans of companies in insolvency, restructuring or recovery proceedings, without the need to provide any guarantees.

6. Solidarity surcharge on the banking sector

Portuguese credit institutions and branches of credit institutions with head-office outside of Portugal will be subject to a solidarity surcharge of 0.02% of the amount of the liabilities (adjusted) and 0.00005% of the value of derivative instruments.

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