Linklaters

27 August 2014

Portugal – Deferred Tax Assets regime

Summary of Law no. 61/2014.

Restoring competitiveness of Portuguese financial institutions

Introduction

Law no. 61/2014, adopting an optional special regime for deferred tax assets ("**DTA**") arising from the non-deduction of expenses and negative variations in net worth resulting from (i) credit impairment losses and (ii) post--employment or long term employment benefits (the "**DTA Regime**") was published yesterday.

The DTA Regime corresponds almost entirely to the Draft DTA Regime included in Draft Law no. 235/XII presented by the Government to Parliament and analysed in our Newsletter of 17 June 2014.

The DTA Regime follows closely the fundamental features of the equivalent Spanish and Italian regimes introduced in recent years and its main purpose consists in restoring some of the competitiveness of Portuguese financial institutions by overcoming the negative impact of the deduction of DTA from regulatory capital (core capital – CET1). However, other Corporate Income Tax ("**CIT**") taxpayers may also elect to apply it.

This newsletter summarises the scope and features of the DTA Regime, with a particular focus on its tax consequences.

Scope

The scope of the DTA Regime can be briefly summarised as follows:

Entities

Entities which may elect to apply the DTA Regime include all companies in general, including Government-owned companies, which have their head-office or place of effective management within the Portuguese territory and the main activity of which is commercial, industrial or agricultural, as well as Portuguese permanent establishments of equivalent companies which are resident for tax purposes in a European Union ("**EU**") Member State or in a country of the European Economic Area ("**EEA**") bound to exchange information in tax matters in a fashion equivalent to that in force in the EU ("**Qualifying PE**").

Contents

Assets

The DTA Regime applies to DTA arising from the non-deduction of expenses and negative variations in net worth resulting from (i) credit impairment losses and (ii) post-employment or long term employment benefits, encompassing:

> expenses and negative variations in net worth booked in tax years beginning on or after January 1, 2015; and

> DTA already recorded in the financial statements of the taxpayer prior to such date, including related expenses and negative variations in net worth.

Features

The DTA Regime provides for two main differences as compared to the standard CIT rules.

New timing of recognition

Expenses and negative variations in net worth which were not deducted in the year they were incurred or booked and which arose from (i) certain credit impairment losses[1] and (ii) post-employment or long term employment benefits, giving rise to DTA being recorded in the financial statements of the taxpayer ("**Relevant DTA**") may be deducted in the tax year in which the conditions for such deductibility according to the standard CIT rules are met, up to the amount of the taxable profit of that year disregarding such deduction and according to a FIFO method. Any excess over the taxable profit of the year may be carried forward to subsequent years, indefinitely (i.e., not subject to the time limitation of tax losses).

Specific rules apply to this adjustment in case of merger of companies which have elected to adopt the DTA Regime, as well as to the application of the adjustment to companies subject to the special tax grouping regime.

The portion of the expenses and negative variations in net worth associated with Relevant DTA converted into Tax Receivables according to the following paragraph may not be deducted.

Conversion into "Tax Receivables"

Relevant DTA duly booked in the financial statements of the taxpayer are converted into Tax Receivables if the taxpayer:

> incurs an annual accounting loss, once its financial statements have been duly approved by the competent corporate bodies; or

> becomes subject to liquidation as a result of voluntary dissolution, court-ordered insolvency or, if applicable, cancellation of authorisation by the regulator or supervisory body.

[1] E.g., credits with related parties under certain circumstances are excluded.

In the case of an accounting loss, the portion of the Relevant DTA to be converted into Tax Receivables corresponds to the proportion between (i) the annual accounting loss and (ii) the equity of the taxpayer (disregarding said loss but including share capital, share premium, reserves, retained earnings and, if applicable, common equity Tier 1 items referred to in article 26 of Regulation no. 575/2013, of 26 June (the "**Regulation**"), and other instruments allowed for purposes of computing common equity Tier 1 issued in the context of recapitalisation measures pursuant to State aid rules and grandfathered in article 483 ff. of the Regulation.

If the former exceeds the latter, or the latter is negative, the Relevant DTA are converted in full. A full conversion also applies in case of liquidation (in which case the taxpayer cannot resume its activities).

Income and positive variations in net worth resulting from the reversal of credit impairment losses, in the portion associated with Relevant DTA converted into Tax Receivables, are included in the taxable profit of the respective tax year.

The Tax Receivables may be used, pursuant to the initiative of the taxpayer, to offset certain debts[2] in respect of State taxes on income and on assets of the taxpayer, of other companies included in the same tax group or, if applicable, included in the same group for purposes of prudential consolidation as per Articles 11 ff. of the Regulation. The eligible tax liabilities are those the taxable event of which does not occur after the conversion into Tax Receivables, provided the deadline for voluntary payment occurs up to the last day of the tax year following the one on which the financial statements are approved by the competent bodies (in the case of an accounting loss). If not used within this timeframe, the amount of the Tax Receivables is immediately refunded to the taxpayer. A Ministerial Order will set forth the details for such offsetting and/or refund.

Special Reserve and Conversion Rights

In the event of a conversion due to an annual accounting loss, the taxpayer is required to create a Special Reserve of the same amount as the Tax Receivables, grossed up in 10%. The Special Reserve may have as sole purposes the increase of the share capital (and, if applicable, in a reserve formed by share premium, subject to the regime of legal reserves), by means of a special share capital increase.

Simultaneously with the creation of the Special Reserve, Conversion Rights are issued and attributed to the State. Conversion Rights are explicitly qualified as securities which grant the holder the right to demand from the taxpayer a share capital increase though the incorporation of the amount of the Special Reserve and ensuing issue and free delivery of ordinary shares in the share capital of the taxpayer. Specific rules for both listed and non-listed taxpayers apply to the computation of the "reference value" of the Conversion Rights.

2

Upon the exercise of the Conversion Rights, the ordinary shares are issued with a subscription price corresponding to the “reference value” of Conversion Rights and attributed for free to their holder. If such price is set below the nominal value of the shares, the subscription price is aligned with that nominal value and the amount of the Special Reserve is adjusted accordingly, according to specific rules provided for in the law.

The State, or any other public entities to which the State may have transferred them in the meantime, may freely dispose of the Conversion Rights but existing shareholders (at the date of their creation) have a call option in the proportion of their shareholdings in the share capital of the taxpayer. A Ministerial Order will set forth the procedures for exercising such call.

Special rules for a Qualifying PE

The DTA Regime applies to a Qualifying PE as follows:

> references to equity and to the resolution of the Shareholders Meeting relate to the relevant EU or EEA legal entity which has a Portuguese Qualifying PE and the obligation to create the Special Reserve and the Conversion Rights apply accordingly, with any necessary adjustments;

> expenses eligible for the DTA Regime must be incurred by the Qualifying PE;

> the Tax Receivables are exclusively used by the Qualifying PE or any Portuguese tax resident entity in the same tax group or, if applicable, included in the same group for purposes of prudential consolidation as per Articles 11 ff. of the Regulation.

Procedures

Election

CIT taxpayers who elect to apply the DTA Regime must communicate that decision to the Tax Authorities within 10 (ten) days from the publication of the law and have the election approved in a Shareholders Meeting.

Among other elements, the resolution of the Shareholders Meeting must specifically approve the creation, features and amount of the Special Reserve, the issue and attribution of the Conversion Rights to the Portuguese State and the share capital increase by means of the incorporation of the Special Reserve.

Among other formalities and procedures, Relevant DTA converted into Tax Receivables, the creation of the Special Reserve and the issue of the Conversion Rights, as well as other conditions, must be attested by a statutory auditor (*Revisor Oficial de Contas*).

Opting out

Having elected to apply the DTA Regime, CIT taxpayers may renounce to its application until the end of the tax year preceding the one on which it is intended that the DTA Regime cease to apply. In the case of financial institutions, opting out depends on prior approval by the supervisor.

Expenses and negative variations in net worth which were not deductible as a consequence of the application of the DTA Regime are deducted from the taxable profit of the tax year on which the DTA Regime ceases to apply.

Next Steps

The DTA Regime enters into force today and the election to apply it must be communicated to the Tax Authorities up to and including 5 September 2014.

A Ministerial Order yet to be enacted will regulate a number of details highlighted above.

Contacts

For further information please contact:

Rui Camacho Palma
Counsel, *Head of Tax*
(+351) 218640011
rui.palma@linklaters.com

Ricardo Reigada Pereira
Managing Associate
(+351) 218640058
ricardo.pereira@linklaters.com

Inês Pisco Bento
Associate
(+351) 218640059
ines.bento@linklaters.com

Avenida Fontes Pereira de Melo, 14-15º
1050-121 Lisboa, Portugal

Author: Rui Camacho Palma

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

© Linklaters LLP. All Rights reserved 2014

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. The term partner in relation to Linklaters LLP is used to refer to a member of Linklaters LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP and of the non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ, England or on www.linklaters.com.
Please refer to www.linklaters.com/regulation for important information on our regulatory position.

We currently hold your contact details, which we use to send you newsletters such as this and for other marketing and business communications.

We use your contact details for our own internal purposes only. This information is available to our offices worldwide and to those of our associated firms.

If any of your details are incorrect or have recently changed, or if you no longer wish to receive this newsletter or other marketing communications, please let us know by emailing us at marketing.database@linklaters.com.