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NOTE

From:	Commission Services
To:	Code of Conduct Group (Business Taxation)
Subject:	Measure – Remuneraçao convencional do capital social (Notional allowance for share capital) - draft assessment

Delegations will find attached a document in view of the meeting of the Code of Conduct Group (Business Taxation) on 15 November 2018.

Measure – Remuneraçao convencional do capital social (Notional allowance for share capital)

Criterion	1a	1b	2a	2b	3	4	5	OA
Notional allowance for share capital								

Paragraph A of the Code of Conduct states that "*this code of conduct, which covers business taxation, concerns those measures which affect, or may affect, in a significant way the location of* business activity *in the Community.*
Business activity in this respect also includes all activities carried out within a group of companies"[1].

The general tax rate in Portugal is 21%. For small and medium-sized companies, a rate of 17% applies to the first 15.000 EUR of taxable income.

The interest deduction on equity (notional interest deduction, hereafter the "NID") was introduced in 2008 and amended in 2014, 2017 and 2018.

The NID base is limited to new cash share capital contributions up to 2.000.000 EUR made by shareholders, third party creditors or by retaining earnings for the purpose of the company's incorporation or increase of capital. The regime does not consider other increase of capital if they do not correspond to company's share capital cash contributions.

For the tax year 2017, the rate of interest deduction on equity is 7%.

According to the information provided by Portugal, this NID regime is mainly aimed at reducing indebtedness of Portuguese SMEs and, in this respect, the NID allowance can amount up to a maximum of 140.000 EUR (2.000.000 * 7%).

In order to avoid tax planning and abuse connected to notional interest regimes, the following limitations of the scope and anti-abuse measures have been identified in a previous assessment[2].

[1] 1 December 1997 ECOFIN Conclusions concerning taxation policy.

[2] Limitation of scope:

- Exclusion of own shares: this exclusion prevents the possibility for a company to increase its equity and simultaneously subscribe the new shares.

- Exclusion of shares held in other resident and non-resident legal persons: this exclusion tackles the possibility to cascade the ACE through chains of equity injection.

- The application of the allowance may not create nor increase tax losses. Consequently, a negative result due to this deduction does not generate a loss carry forward.

- Assets not necessary for conducting business: this is a classical exclusion in NID systems to avoid benefiting from NID on assets that do not generate taxable income (for instance, luxury goods, artwork, etc.).

- No deduction of NID with regard to capital which is allocated to a foreign permanent establishment. If the foreign PE was a legal person (a subsidiary), the parent company holding its capital would have to exclude those shares from the ACE base.

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Portugal's Notional interest deduction rules include the following **limitations of its scope**: The regime covers only new share capital contributions. The maximum allowance is 140.000 € per company per year. The transfer of any kind of assets is excluded. Participations and foreign PE are not taken into account. The NID allowance cannot create losses. Excess amounts can be carried forward in accordance with the general rules of the Portuguese CIT Code.

Given the limitations of the scope, there is no need for **specific anti-abuse provisions** with regard to the transfer of participations, the re-categorisation of old capital, the creation of subsidiaries, the acquisition of businesses held in associated enterprises and the increase in the amount of loan receivables. Portugal has an anti-abuse provision to avoid cascading by intra-group loans (article 41-A(6) Estatuo dos Beneficios Fiscais (EBF)). Contributions in kind are limited to the conversion of shareholder loans occurring after 1 January 2017 or third party credits occurring after 1 January 2018 (article 41-A(2) EBF). Double dipping structures are neutralised or mitigated by a reduction of the limit on the deductibility of funding expenditure from 30% to 25% of the EBITDA, when a NID deduction is granted (article 41-A(5) EBF and 67(1)(b) IRC.

Portugal has a **general anti-abuse provision** (article 38(2) Portuguese General Taxation Law).

Based on the limited scope of the NID, Portugal has a robust combination of specific and general anti-abuse provisions which deal with the identified abusive cases.

Portugal provided the following data on the use of the NID regime since 2013:

Tax period	2013	2014	2015	2016
Number of beneficiaries	631	1440	2044	3299

Anti-abuse rules targeting specifically transactions between related parties: The proposal for an EU Directive on a common consolidated tax base (CCCTB) contains an allowance for growth and investment (AGI). Art. 11(6) of the CCTB reads as follows:

"*The Commission shall be empowered to adopt delegated acts in accordance with Article 66 to lay down more detailed rules against tax avoidance, and more particularly in the following fields relevant to the AGI:*

(a) intra-group loans and loans involving associated enterprises;

(b) cash contributions and contributions in kind;

(c) transfers of participations;

(d) the re-categorisation of old capital as new capital through liquidations and the creation of start-ups;

(e) the creation of subsidiaries;

(f) acquisitions of businesses held by associated enterprises;

(g) double-dipping structures combining interest deductibility and deductions under the AGI;

(h) increases in the amount of loan financing receivables towards associated enterprises as compared to the amount of such receivables at the reference date."

Number of foreign owned beneficiaries	0	7	13	32
Global amount of NID granted	1.300.948,36€	3.503.749,4€	4.903.392,39€	7.532.554,60€
Total tax expenditure	325.237,09€	654.053,81€	917.581,39€	1.407.269,82€
Total tax expenditure applicable directly or indirectly to foreign owned companies	0€	10.743,94 €	33.102,13€	64.107,80€

From the 3299 taxpayers benefiting from the regime in 2016, only 32 (1% of the total) are directly or indirectly foreign owned companies (64% of which are majority foreign owned companies).

The amount of NID allowance granted to each of the 3299 companies that benefited in 2016 is, calculated as an average, of 2.283,28€ per company.

The average NID tax expenditure attributable to directly or indirectly foreign owned companies is 64.107,80€/32 = 2.003,36€.

Considering these factual elements combined with the maximum NID allowance of 140 000 EUR, we are of the opinion that a NID regime such as the Portuguese regime cannot affect in a significant way the location of business activity in the EU, in the sense of paragraph A of the Code of conduct.

Therefore, we suggest considering this regime as being out of the Code of conduct scope and subject to monitoring by the Commission services with regard to its economic effects.

Question:

- ***Do delegates agree that the Portuguese NID regime cannot be considered as potentially affecting in a significant way the location of business activity in the EU?***
- ***Do delegates agree that Portugal should annually provide relevant data on the use of its regime so that the Commission services can report to the Group on the regime's potential effect on the location of business activity in the EU?***