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A blow to the HoldCo: removal of benefits could prompt relocalisation

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Until the end of 2010, Portuguese holding companies - termed *sociedades gestoras de participações sociais* (SGPSs) - had two major tax benefits.

First, they enjoyed tax exemption for dividends received from controlled companies - the regime for elimination of economic double taxation under the Internal Revenue Code applied, with no requirements in respect of percentage, participating value or effective taxation of the profits that were the source of the dividend.

Second, capital gains and losses incurred by an SGPS from the corporate rights held (1) and financial charges borne in the acquisition of a company were not considered part of the taxable profit of these companies.

However, following the financial crisis, good tax legislation policy seems to have been thrown out with the bad. The 2011 Budget revoked the exemption of dividends for SGPSs, which may now benefit only from the general regime for elimination of double taxation under the code. SGPSs that wish to benefit from the elimination of double taxation on dividends must comply with the following criteria:

- The SGPS must directly hold a participation of at least 10% in the capital of the controlled company, such participation being held, without interruption, for one year before the date on which the realised profits were made available. If such participation is held for less time, the benefit will not cease insofar as such participation is held during the period necessary to complete the year.
- The dividends must originate in effectively taxed profit.

However, this raises the question of what constitutes effectively taxed profit. There seems to be no satisfactory answer. Some commentators have argued that it does not matter, as long as the profit was subject to tax at some stage of the participation chain, but this view seems inconsistent with opinions previously issued by the tax authorities. Before the problem arose in relation to holding companies, the tax authorities set out the unofficial position that in order for the regime for elimination of double taxation to apply, the profit had to be effectively taxed on the company that is paying the dividend. The report on which the Budget legislation was based essentially takes the same view.

If this position prevails, an SGPS that has an indirect participation will be taxed on the dividends paid by the directly controlled company - once the latter benefits from the elimination of double taxation, the dividend that it pays to the holding company is not taxed.

It is unclear how this situation can apply in practice, as the reality is much more complex: a dividend cannot be split into an effectively taxed and a not effectively taxed dividend. If a directed, controlled company receives dividends, but also makes a profit from its own business, how will the SGPS know what to tax?

Unfortunately, the problem is even more complicated. The tax authorities' unofficial position requires that this effective taxation condition be met even on dividends paid by companies outside Portugal but within the European Union, since this condition is supposedly an anti-abuse clause and therefore allowed by the EU Parent-Subsidiary Directive (90/435/EC). SGPSs are not alone in being confused.

At present, companies and their tax advisers remain in the dark about the change. Portugal's political and financial situation only makes matters worse: any clarification from the tax authorities is likely to have a heavy political bias at a time when making a profit seems to be regarded as a sin. However, serious damage has already been done: confidence has been shaken and many companies are considering delocalising their holding companies to the Netherlands or Luxembourg. This would be a blow not only to the holding companies, but also to the Portuguese economy and the tax that it

needs to collect.

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Endnotes

(1) If held for at least one year.

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