dateline Portugal

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TAX INCENTIVES FOR INVESTMENTS

Portugal has enacted a new regime of tax incentives for productive investment projects and investment projects for the internationalization of Portuguese companies. It will cover investment projects to be executed until the end of 2020 related to (1) extractive and manufacturing industries; (2) tourism; (3) computing and related activities; (4) agriculture, fishing, farming and cattle raising, and forestry; (5) R&D and technology intensive activities; (6) information technology and audiovisual and multimedia; and (7) the environment, energy, and telecommunications. Further, tax incentives are available for investments made directly in other jurisdictions concerning (1) activities related to centers of competitiveness and technology; (2) real estate development, public works, and associated architectural and engineering activities; and (3) transport and logistics.

Productive Investment Projects

Apart from these general criteria, the new regulations specifically provide that to benefit from the tax incentives, productive investment projects must (1) represent an investment of at least €5 million; (2) be relevant for the strategic development of the economy; (3) be relevant for the reduction of regional asymmetries; (4) contribute to the creation or maintenance of jobs; and (5) help improve technological innovation and scientific research.

The tax incentives for this type of investment are granted through an agreement, with a duration of up to ten years, between the promoters of the projects and, depending on the circumstances, IAPMEI (the Portuguese agency to support small and medium sized enterprises and innovation) or AICEP (the Portuguese agency for investment and cross-border trade) and it is approved by a resolution of the Council of Ministers. Such incentives encompass a credit against the taxpayer's corporate income tax liability, ranging from 10% to 20% of the investment made depending on the fulfillment of other criteria and requirements established in the law; an exemption or tax rate reduction on the acquisition of immovable property (normally 6.5% on the amount of the agreement); the annual tax on immovable property (normally between 0.2% and 0.4% of the tax value of the property); and the stamp duty that may be due on any agreement entered into for the development of the project. In this type of investment, there is also the opportunity of entering into advance pricing agreements with the tax authorities.

Internationalization of Portuguese Companies

To qualify for the incentives for the internationalization of Portuguese companies, projects must (1) represent an investment of at least [euro]250,000; (2) reveal strategic interest for the internationalization of the Portuguese economy; (3) be technically, economically, and financially viable; (4) not be located in a tax haven; and (5) not involve a job decrease in Portugal.

Two tax incentives are created for this type of investment. The first is a tax credit of 10% of the investment made in (1) the creation of branches or other permanent establishments abroad; (2) the acquisition of shareholdings in non-resident companies or the incorporation of a company abroad, provided that the direct shareholding represents at least 25% of the company's share capital; and (3) multi-year promotional campaigns in foreign markets. The tax credit is granted for up to five years, with the possibility of carrying forward (five years)

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any excess credit against the taxpayer's corporate income tax liability, up to 25% of the liability, with a limit of Euro 1 million per year. The credit may be increased by 10% for an investor that is a small or medium-size company, as defined in the Community law.

The second tax incentive offers the possibility of benefiting from the participation exemption regime on the distribution of profits to the investor. The possibility of entering into advance pricing agreements with the tax authorities also applies to this type of investment.

Other Requirements

To benefit from these tax incentives, the promoters must follow specific procedures; have the requisite technical and management ability, a balanced financial situation, and regularly organized accounting; comply with the rules on public procurement, the environment (i.e., national and EU regulations), and equality of opportunity and competition; and their financial contributions must correspond to at least 25% of the eligible costs, free from any public support.

The required procedures begin with the submission of applications, electronically, to AICEP or IAPMEI, depending on the circumstances. Those entities will then submit all of the applications to another administrative organ that is responsible for checking the project's compliance with the eligibility conditions and for issuing a report on the tax incentives to be contracted.

The granting of these tax incentives always depends on fulfillment of the applicable EU provisions—in particular, EC Regulation no. 800/2008 (August 6, 2008), declaring certain categories of aid compatible with the common market, and EC Regulation no. 1998/2006 on de minimis aid.

Finally, only projects that have not been initiated before the online submission of the applications are eligible to benefit from this regime, except for expenses for studies related to the investment if performed less than one year before submission of the application. ●

U.S. Tax Bills

(Continued from page 37) instance, the contract were over a fixed basket of U.S. securities, each one of which was readily tradable on an established securities exchange.[49] It would seem sensible to treat the index in this situation as publicly traded.

It remains uncertain what will constitute a specified notional principal contract under subsequent Treasury guidance. In the 2010 Green Book, Treasury proposed a safe harbor that would have applied to maintain the non-U.S. sourcing of income from swaps with a 90-day or greater term and certain other characteristics (e.g., 20% collateral limit, crossing limitation, and 20% of the 30-day average daily trading volume swap limit). Whether these factors or variations will still be used in future Treasury guidance is unclear.

If a minimum term is ultimately imposed, some commenters and financial services groups have argued that 90 days is unduly long. Other Code Sections dealing directly or indirectly with the issue of beneficial ownership provide for shorter holding periods.[50] The 90-day term requirement is also arguably inconsistent with (and perhaps unworkable in the context of) normal trading strategies of non-tax-motivated market participants. It also is unclear how the term of the swap would be measured for this purpose (e.g., actual number of days elapsed in the relevant swap or maximum term in the relevant swap confirmation).

The 2010 Green Book also proposed that no more than 20% of the notional principal amount was to be posted as collateral for the swap. No distinction was made, however, between collateral borrowed by the short party and collateral that could not be so borrowed. Practitioners also have argued that if the purpose of the requirement was to ensure that the swap's borrowing component constituted a significant business purpose, a 40% collateral limit also could be reasonable (being still below the 50% regulatory limit on margin straight borrowing). Several technical concerns also will have to be addressed in respect of this limitation.[51]

Questions also remain regarding potential Treasury guidance dealing with the pricing of the swap. For instance, does Treasury intend to require or prohibit the use of a specific pricing method (e.g., variable weighted average pricing (VWAP), risk bidding, and market on opening or close)? Also, will the same crossing test in the Tax Extenders Bill and the 2010 Green Book (under which crossing in *or* out would trigger immediate re-sourcing) be adopted or will the approach in the IRS audit guidelines prevail, permitting crossing in absent any cross-out?

Practitioners have argued that even if withholding were to apply to swap payments made under a re-sourcing rule, the amount subject to withholding should be the amount actually paid to the long party, net of any financing payment made by that party. The Tax Extenders Bill and the

[49] It also is unclear how a fixed basket of stock that includes U.S. and non-U.S. equities would be treated for this purpose.

[50] For instance, Section 1091 (wash sale transactions) provides for a 30-day holding period. Sections 246 (dividends-received deduction) and 901 (limitations on foreign tax credits) require a 45-day holding period (a longer period is required for certain preferred stock).

[51] These concerns include whether the collateral test will apply only to the initial margin or the adjusted margin through the term of the swap and whether securities posted as collateral should be valued for this purpose taking into account standard "haircuts" that dealers typically use in their operations.

[52] Read literally, the provision (even as clarified) would also seem to subject to the re-sourcing rule substitute payments on loans of stock of foreign corporations. The HIRE Act would provide for a stand-alone definition that would correct this drafting concern.

[53] The Notice was published to address concerns that the U.S. sourcing rule for substitute payments could cause the total U.S. withholding tax imposed in a series of securities lending or sale and repurchase transactions to be excessive (i.e., a "cascading" effect). It is believed that certain taxpayers have taken the position that the Notice allows the complete elimination of withholding taxes in some circumstances. See, e.g., United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, "Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends," Staff Report, September 11, 2008, pages 18-20, 22-23, 40, 47, 52; Green Book, page 37.

HIRE Act, as did the Foreign Account Bill, take the opposite approach, requiring withholding on the gross amount of the dividend equivalent payment.

The Tax Extenders Bill and the HIRE Act further give the Secretary the authority to make other types of contracts that are not notional principal contracts (as defined in Regulations), but provide for returns similar to dividend equivalent payments, subject to the re-sourcing rule. For example, the Tax Extenders Explanation says that a forward contract that references stock of a U.S. corporation could become subject to future Treasury guidance under this grant of authority.

As discussed above, the Tax Extenders Bill provides that a "substitute dividend payment" constitutes a dividend equivalent payment subject to the re-sourcing rule. The Tax Extenders Explanation clarifies that "substitute dividend payment" should be defined by reference to Reg. 1.861-3(a)(6), which deals with the source of payments made on a securities lending or sale-repurchase transaction.[52] The re-sourcing rule under the Tax Extenders Bill seems consistent with the re-sourcing rule in the Regulations, and appears to be aimed at implicitly repealing the cascading withholding avoidance mechanism in Notice 97-66, 1997-2 CB 328.[53]

The Tax Extenders Bill also provides that, for a chain of dividend equivalents, one or more of which is subject to tax under the proposal, the Secretary may issue guidance to reduce that tax. This relief will be available only if the taxpayer can establish that the tax has been paid with respect to another payment in the chain (including, for this purpose, by withholding on the actual dividend paid on the underlying U.S. stock). Several questions arise from this proposal, including how a taxpayer may satisfy the proof-of-withholding requirement, especially where there is a long chain of contracts linked by dividend equivalent amounts. The HIRE Act provides that the Secretary may issue regulations as appropriate to address the role of financial intermediaries in such a chain, which may provide some relief to financial institutions entering into swaps and stock loans as intermediaries to facilitate positions for their customers. Nonetheless, no relief appears available until Treasury issues the relevant guidance, which may create double or greater taxation of dividend equivalent payments in the interim period.

Two final and important issues raised by the re-sourcing rule relate to its effective date. First, the bills provide that the rule, and its potential withholding implications, should apply to payments that occur 90 days after the date of its enactment. Accordingly, if enacted in the coming months, the Tax Extenders Bill could potentially be effective early in 2010. The HIRE Act would extend the effective date to 180 days from the date of enactment of the bill, which would provide some relief to market participants. Nevertheless, even this extended effective date would require affected parties to quickly put in place administrative and IT measures to ensure compliance with the provision and minimal disruption to their activities. Some financial institutions have suggested that it might not be realistic to implement all of the required changes within even the extended time frame.

Second, the Tax Extenders Bill does not contain a grandfathering provision for payments made pursuant to derivative contracts entered into prior to its proposed effective date. Therefore, the current version of the Bill would require that dividend equivalent payments on contracts that are already outstanding be subject to withholding and potential gross-up by the payor (based on the standard market documentation for swap and securities loans transactions). This gross-up obligation may cause payors to seek early termination of these contracts, causing potential disruption in the market.

Conclusion

The changes introduced by the Foreign Account Bill and by subsequently proposed legislation are sweeping and demonstrate a strong will by Congress to clamp down on U.S. tax evasion through offshore accounts, trusts, bearer bonds, and structured derivatives. As shown by the Obama Administration's views in the 2010 and 2011 Green Books, most of these proposals have strong support within the Executive Branch and are likely to be signed if ultimately passed by Congress.

While Congress's objective is commendable, some of the provisions, especially the proposed withholding tax imposed on foreign financial institutions (defined broadly) that do not comply with quite invasive new disclosure requirements, would represent a sharp departure from the current U.S. enforcement regime. Without further modification, this new provision would adversely affect market participants that comply with current law and are not remotely involved in tax evasion, and may affect the willingness of financial institutions to trade or hold U.S. assets. The provision dealing with the re-sourcing of payments under specified notional principal contracts also requires further action by the government to ensure that proper guidance is in place on or shortly after its enactment. ●