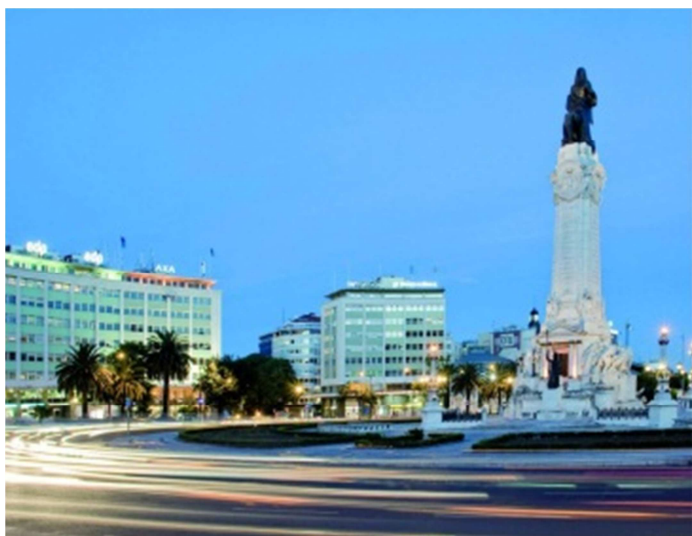


## BREXIT'S TAX IMPACT IN PORTUGAL



## TAX &amp; BUSINESS



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## SUMMARY

The Brexit referendum on June 23 kicked-off a chain reaction throughout the tax and legal spectrum, with an immediate impact on the economy. It is most opportune to consider Brexit's impact in light of the array of exit strategies that may be adopted by the UK and the EU. Namely, the impact in taxation and cross-border investment between UK and Portugal, cross-border workers and pensioners in each of these countries, as well as the opportunities already in place in the Portuguese tax regime.

## I. INTRODUCTION

1. The Brexit referendum on June 23 kicked-off a chain reaction throughout the tax and legal spectrum, with an immediate impact on the economy. UK's withdrawal process from the EU may last up to two years, after the UK gives formal notice of its intent to leave the EU, under Article 50 of the EU Treaty and if the parties do not de facto extend it.

Any agreement would require unanimity among all Member States. Therefore, it is expected to be a daunting process due to the need of determining the acquired rights of a large number of UK citizens living in other Member States and EU citizens living in the UK, as well as the need to minimize the economic impact and cross-border investment.

Moreover, the numerous stakeholders and decision makers involved make the actual length of the process uncertain.

As the days in the aftermath of the referendum have shown, an absolute avoidance from

Brexit's impact may not be possible. Due to the manifold risks, an assessment of the actual risks is opportune, having regard to each person's particular facts, circumstances and concerns, so that a course of action directed at mitigating such risks.

2. In this context, Portugal was considered to be the fourth most impacted country within the EU, mainly due to the exports to the UK, the high number of Portuguese immigrants in the UK and vice-versa, sizeable UK bank links and Portugal's weak position to withstand the macroeconomic consequences that are expected to unfold.

Moreover, it is most opportune to consider Brexit's impact in light of the array of exit strategies that may be adopted by the UK and the EU. Namely, the impact in taxation and cross-border investment between UK and Portugal, cross-border workers and pensioners in each of these countries, as well as the opportunities already in place in the Portuguese tax regime.



## II. EXIT STRATEGIES AND SUBSEQUENT LEGAL FRAMEWORKS

3. First, the exit could be based on Norway's arrangement, where the UK would remain part of the European Free Trade Association (EFTA) and of the European Economic Area (EEA), which would still give it access to many of the advantages inherent to the EU, namely free trade agreements, the single market and its regulatory framework and the fundamental freedoms that so strongly characterize the EU. However, this solution wouldn't address does not address UK's political concerns with the EU.

Second, a more specific and negotiated access to the single market could be negotiated, as it is the case with Switzerland. However, this agreement has become increasingly unattractive to the EU.

Third, a customs union could be created, modelled after the agreement between the EU and Turkey.

Lastly, the UK could rely on its existing network of double tax conventions and rules and agreements related to the World Trade Organization (WTO) and the General Agreement on Tariffs and Trades (GATT).

4. Eventually, bilateral investment treaties may be negotiated between the UK and other EU countries, such as Portugal, as the European Commission has, in effect, disallowed their use between EU Member-States due to Competition and State Aid concerns.

In any of the proposed models, the UK would still benefit from the freedom of movement of capitals and the decisions by the Court of Justice of the European Union, as the EU's purview was enlarged to protect investments from non-EU countries in 2009.

## III. TAXATION OF DIVIDENDS, INTEREST AND ROYALTIES

5. The double tax convention between the UK and Portugal does not offer the same

withholding tax elimination effect as the EU's direct tax directives, which apply, namely, to company groups, still allowing withholding taxes on cross-border dividends (15% or 10%), interest (10%) and royalty (5%) payments.

Therefore, companies with cross-border investments may like to revise their current strategy and determine the potential risk and impact of this change, in order to eliminate or mitigate international double taxation.

On the other hand, Portugal remains an attractive investment location, as a company may benefit from the participation exemption regime, which would, nevertheless, be applicable to cross-border flows of income and capital gains between the UK and Portugal because the existing double tax convention also enables the use of such regime.

Furthermore, with or without Brexit, a Portuguese based company may elect to exclude profits and losses from a permanent establishment that it has abroad, thus

segregating the foreign and domestic income for taxation purposes.

### MERGERS AND ACQUISITIONS

6. The Mergers Directive, which removes certain EU cross-border tax obstacles to mergers and acquisitions, would no longer encompass the UK.

The Portuguese special regime for tax neutrality in mergers and acquisitions, in the same vein as the Mergers Directive, is limited to EU based companies. Therefore, any such operation would likely have to be performed within the timeframe of the exit procedure.

### CROSS-BORDER LOSSES

7. The fragmentation of loss relief for companies is still an ongoing issue within the EU, but the relatively little progress made through the European Court of Justice's decisions will disappear with Brexit. This background may soon change if the so called Common Consolidated Corporate Tax Base (CCCTB) Directive is introduced in the EU. This



Directive would provide companies a common legal framework to calculate profits and losses throughout the EU Member-States and, eventually, EFTA/EEA Member-States, allowing, particularly, the offset of profits and losses that companies make in different Member States. Depending on the exit strategy adopted by the UK, it may not benefit from this development in EU Tax Law.

#### **BASE EROSION AND PROFIT SHIFTING (BEPS) AND THE EU ACTION PLAN FOR FAIR AND EFFICIENT CORPORATE TAXATION**

11. Another main and longstanding feature of EU taxation lies in the Customs Union, from which the UK would also exit unless it enters into a special agreement with the EU. If an agreement cannot be reached, then the UK would rely on the standards and regulations that are derived from the World Trade Organization (WTO) and General Agreement on Tariffs and Trade (GATT).

#### **CROSS-BORDER WORKERS AND PENSIONERS**

12. Individuals already residing in the UK or in EU Member-States are expected to be the

focus of special protections during an eventual agreement between the EU and the UK. However, with the EU case law not being imposed on the UK, cross-border workers may lose certain EU tax case law benefits related to personal deductions.

In this context, the non-habitual resident regime in place in Portugal, meant to attract highly skilled professionals, high net worth individuals and foreign pensioners, now gains renewed interest. Non-habitual residents are the individuals who became resident in Portugal and, during the five years prior to their registration as resident, were not domiciled, for tax purposes, in Portuguese territory; granting qualifying individuals an inarguably advantageous tax regime.

Moreover, Brexit will trigger interest in the Portuguese golden visa regime, directed at high net worth individuals interested in obtaining a residence permit in Portugal through investment activities, particularly real

estate, transfers of capital or creation of at least ten workplaces.

### CONCLUSION

13. Individuals and enterprises that engage in cross-border transactions between the UK and Portugal are left with plentiful lingering tax and legal question.

The immediate economic impact brings along a strong sense of urgency. Nevertheless, the time during which the exit procedure is being negotiated should not have an impact on the available EU protections, namely directives, regulations and case law.

Therefore, there is yet some time to observe, seek counsel, assess and ultimately decide on any necessary course of action.

Lisbon, 30th of June of 2016

Rogério M. Fernandes Ferreira

Marta Machado de Almeida

Sérgio Brigas Afonso

Jorge Lopes de Sousa