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TAX LAW

EFFECTIVE TAXATION ON DISTRIBUTED PROFITS

THE CHANGES INTRODUCED BY LAW 55-A/2010 OF 31 DECEMBER (STATE BUDGET LAW FOR 2011) WITH REGARD TO TAXATION ON DIVIDENDS DISTRIBUTED ON HOLDING COMPANIES (SGPS IN PORTUGUESE).

The changes introduced by Law 55-A/2010 of 31 December (State Budget Law for 2011) have had a substantial impact on Holding Companies (SGPS in Portuguese), with regard to taxation on dividends distributed to them, with the result that these companies will now be subject to the same conditions applicable to companies in general.

Presently, Holding Companies will no longer be able to benefit from the double taxation avoidance system when the Holding Company's shareholding in the company distributing profits is less than 10%, or when the dividends distributed have not been subject to **effective taxation**.

Thus, Holding Companies, as is the case with companies in general, are no longer eligible for 100% deduction on dividends received from their shareholdings in cases where the shareholding is less than 10%, or where there is no **effective taxation**. In practice, Holding Companies are fully eligible for taxation under the IRC, with regard to dividends received, without enjoying any mechanism for avoiding double taxation.

In spite of introducing changes in such a sensitive matter, the legislating body, on publishing the State Budget Law for 2011, did not clarify its understanding of effective taxation.

However, the question of how the Tax Authorities will interpret the concept of **effective taxation** is for the moment clarified with the publication of Circular 24/2011 of 11 November, 2011.

Thus, by an Order of the Secretary of State for Tax Affairs, the Tax Authorities have clarified that the effective taxation requirement must be interpreted in the sense of requiring that the income be derived from profits that have been subject to IRC or any other similar or analogous tax, from which it is not exempt or excluded. It is also sufficient for taxation to have taken place within the legal sphere of one of the entities forming part of the attribution chain, that is, for taxation to be verified within the legal sphere of the distributing entity or legal sphere of its affiliate.

The above mentioned Order establishes, by way of example, that profits are considered as effectively taxed in the

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absence of a tax burden as a result of the deduction of tax losses because these profits are derived from income that is part of the taxable profit.

The effective taxation requirement is considered as applicable when the company generating the distributed profits does not enjoy any exemption and such profits arise from income that is not covered by any exemption.

Lastly, the Order of the Secretary of State for Tax Affairs has clarified that there is no minimum taxation limit, that is, the distributed profits are not covered by a minimum threshold for the effective taxation rate.

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