

GMS Flash Alert

2023-116 | June 7, 2023



Portugal – New Tax and Legal Regimes for Start-ups and Scaleups

Portugal's parliament has approved new rules that provide for the definition of legal concepts for "Start-ups" and "Scaleups," how such entities are recognised, changes to the taxation of share and stock option plans for employees of Start-ups, of companies that qualify as micro-, small-, or medium-sized enterprises or as "small mid-cap," and of companies in the "innovation" sector. A reinforcement of the system of tax incentives for business research and development is also foreseen in the new rules.

The aim of this legislation is to establish new regulatory and tax regimes that encourage the creation of Start-ups and Scaleups, as well as the development of their activities in Portugal.

Law no. 21/2023 was published on 25 May and entered into force on 26 May.¹

WHY THIS MATTERS

The enhanced structure around the definition of Start-ups and the manner in which they remunerate their employees through various forms of equity, and the tax treatment related thereto, should contribute to the development of start-up companies and encourage entrepreneurial activity.

The more favourable tax rate under Law no. 21/2023 – as compared to the rates under previous rules – should make this form of compensation more attractive and help give the Start-ups/Scaleups sector a boost, as well as encourage innovation and entrepreneurship.

Extending the tax-preferential period for stock options means that they could be a more attractive way of compensating individuals in the Start-up sector.

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Context: Equity Compensation and Taxation

There are several different reasons why companies choose to implement options and share plans or the equivalent and those will naturally depend on the size of the company and its specific objectives, namely:

1. recruiting, retaining, and motivating employees;
2. offering a competitive remuneration package compared to other employers/competitors;
3. improving the employee's performance;
4. aligning interests of shareholders and employees;
5. encouragement of employees' loyalty.

According to the Portuguese Personal Income Tax Code, any gains derived from the attribution of stocks/options/purchase rights by the employer are deemed as employment income.

The taxable moment for the attribution of shares/purchase rights occurs at grant. Nonetheless, in case (i) the shares/purchase rights, (ii) the disposal rights, and (iii) the right to receive the stock purchase rights' forfeitures in case of termination (at least, in a "bad leaver" scenario) are only transferred to the employees at the end of a restriction period imposed under the plan (i.e., the vesting/settlement date), taxation shall occur at the vesting/settlement (and not at grant). On the other hand, the taxable moment for the attribution of stock options shall occur at exercise.

The taxable amount shall correspond to the difference between the Fair Market Value (FMV) of the stocks/options/purchase rights at the taxable event and the amount paid by the employees to acquire them (if any).

Especially regarding employment income, taxation is due at the marginal tax rates applicable to "ordinary" residents up to 53 percent. In case the employee decides, in a later moment, to proceed with the sale of its shares, the capital gain (if any) is taxed at a flat rate of 28 percent.²

For Social Security purposes, the discounts awarded in respect of the acquisition of the employer's shares and stocks are excluded from Social Security and, therefore, no Social Security contributions shall be due in Portugal on this income.

New Rules

As per the Law no. 21/2023, it is foreseen that the income arising from the participation of the employees in the herein-noted plans will now be taxed over 50 percent of its amount – provided that the underlying assets are held for more than one year – and will be subject to a special rate of 28 percent (i.e., corresponding to an effective rate of 14 percent), with the option to aggregate such income to any other income received that is taxed at progressive tax rates. Example:

- Previous rule: If Maria – a regular resident for tax purposes in Portugal – is granted by her employer 500 shares (that meet the above criteria) at no cost, and assuming that at the taxable moment the shares' market value is EUR 1.00, the taxable employment income shall amount to EUR 500.00, and it will be subject to taxation at the marginal tax rates up to 53 percent.
- New rule: Considering the same situation, in this case the taxable employment income shall amount to EUR 250.00 and shall be subject to taxation at a flat tax rate of 28 percent.

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In addition, taxation of the income received by employees under these plans is postponed to the earliest of the following: i) disposal of shares or gift of shares or equivalent rights, or ii) loss of tax residency status in Portugal.

Taxable income will be determined depending on the taxable moment, as follows:

1. In case of disposal of the shares: the taxable income shall correspond to the positive difference between the sale's proceeds and the price paid by the employee (if any);
2. In case of gift of shares: the taxable income shall correspond to the difference between the amount that would be subject to Stamp Duty, if applicable, and the price paid by the employee (if any); and
3. In case of the loss of tax residency status: the taxable income shall correspond to the positive difference between the Fair Market Value and the price paid by the employee (if any).

To this end, the plan will have to be attributed by an entity that, in the year prior to the approval of the plan, is recognised as a Start-up, under the terms of the legal regime in force.

This regime is not exclusive to Start-ups, since it can also be applied by companies that qualify as (i) micro-, (ii) small-, or (iii) medium-sized enterprises (or as "small mid-cap"), as well as to companies that develop their activity within the innovation sector (regardless of their size).

KPMG INSIGHTS

In this sense and considering the additional tax benefit granted to those who benefit from the eligible share (or equivalent) plans, such companies could reasonably expect to be able to attract even more talent and retain it (compared to other companies that are not able to benefit from this new regime) since they will, for instance, be able to offer a more attractive remuneration package.

Exclusions

Taxpayers who directly or indirectly hold 20 percent or more of the share capital or voting rights of the entity granting the plan are excluded from this benefit, as are members of the statutory bodies of the entity granting the plan, unless such entity qualified as a Start-up or as a micro- or small-size company in the year prior to the approval of the plan.

KPMG INSIGHTS

The new regime has effect as of 1 January 2023. The tax incentive related to the acquisition of shares in Start-ups is also applicable to equity compensation plans approved up through 31 December 2022, on the basis that the incentive relates to an entity that, within the 12 months following the entering into force of this new law, is recognised as a Start-up under the terms of the applicable legal regime, or, is able to demonstrate that on the date of the approval of the plan it qualified as a Start-up.

If employers have questions regarding existing rules, and/or the expected changes that will apply to Start-ups and Scaleups, the definition of those options and share plans (or equivalents), or to assess the eligibility of an existing plan,

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KPMG INSIGHTS (cont'd)

what the conditions of eligibility are, and what the tax consequences and registry/reporting obligations may be, they should contact their qualified global reward professional or a member of the Personal Advisory Services team with KPMG in Portugal (see the below Contact Us section).

FOOTNOTES:

1 For the text (in Portuguese) of the legislation, Law no. 21/2023 (*Lei n.º 21/2023, de 25 de maio*), see: <https://diariodarepublica.pt/dr/detalhe/lei/21-2023-213498830>.

2 Notwithstanding the above, the capital gains arising from the sale of shares and other securities will necessarily be taxed at the marginal tax rates, provided that *i)* the assets have been held for less than 365 days, and *ii)* the annual taxable income of the taxpayer (including the balance of the capital gains and capital losses), amounts to or exceeds EUR 78,834.00.

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Contact us

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