DEDUCTIBILITY OF EXPENSES FOR CORPORATE INCOME TAX PURPOSES (PIV_25762)

ALL FINANCE MATTERS

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Introduction

In many micro and small companies, particularly those providing services, it is common for the company's registered office to coincide with the tax residence of the shareholder or managing shareholder. In most cases, this choice is driven by practical and economic considerations, such as reducing costs related to rent, offices or dedicated business premises.

However, this arrangement often raises tax-related questions, especially regarding the deductibility, for corporate income tax (IRC) purposes, of certain expenses connected to the property, such as electricity, water, internet or telecommunications. It is therefore important to clarify how these situations should be treated, in light of the applicable legislation and the most recent position of the Portuguese Tax Authorities.

Tax treatment of expenses

When the company's activity is carried out, even partially, at the managing shareholder's residence, certain expenses will naturally be attributable to that activity. Typical examples include electricity, water, internet or telephone costs, all of which are essential for the day-to-day operation of the business.

Under Article 23(1) of the Portuguese Corporate Income Tax Code, expenses are tax deductible where they are demonstrably necessary for the generation of taxable income. In this context, costs incurred in connection with a property used as the company's place of work will generally fall within this scope.

In practice, the main difficulty arises from a documentation perspective. In most cases, invoices for these expenses are issued in the name of the shareholder, as the owner or tenant of the property, rather than in the name of the company. Tax legislation requires expenses to be properly documented and, where applicable, supported by invoices issued to the entity claiming the deduction. For many years, this requirement has represented a significant obstacle to the deductibility of such costs for IRC purposes.

Historically, the Portuguese Tax Authorities adopted a strict approach in these situations, frequently challenging the deductibility of expenses where the company's registered office was located at the shareholder's or managing shareholder's residence.

The recent position of the Portuguese Tax Authorities

This position has recently become more flexible following the issuance of Binding Ruling no. 25762, dated 2 September 2024, by the Corporate Income Tax Department.

In this binding information, the Tax Authorities were asked to clarify whether a company could deduct, for IRC purposes, expenses related to electricity, water, internet and telephone services where its registered office was located at the managing shareholder's tax residence. The alternative option of entering into a lease agreement between the shareholder and the company was also considered.

The Tax Authorities accepted that it may be permissible for the shareholder to recharge the company with a proportional share of the expenses incurred, even where the supporting invoices are issued in the shareholder's name, provided there is a formal agreement between the parties. This agreement should clearly identify the expenses to be allocated to the company and define the criteria used to apportion those costs.

The apportionment method must be reasonable, objective and capable of justification. As an illustrative example, the Tax Authorities refer to allocation based on the proportion of the property's area used by the company compared to the total area of the property, although other appropriate and well-substantiated criteria may also be acceptable.

Alternatively, a lease agreement may be entered into between the managing shareholder and the company in respect of the part of the property allocated to the business activity. In this case, rent and related costs may be treated as deductible expenses for IRC purposes, provided they meet the requirement of necessity set out in Article 23 of the Corporate Income Tax Code.

It should also be noted that, in all of these scenarios, transactions are taking place between related parties. As such, the terms agreed must reflect arm's length conditions, and compliance with the transfer pricing rules set out in Article 63 of the Corporate Income Tax Code must be ensured.

Impact on the personal income tax reinvestment regime

In addition to the implications for corporate income tax, it is essential to consider the potential consequences for personal income tax (IRS), particularly with regard to the capital gains reinvestment regime.

Where the company's registered office is located at the shareholder's residence, the property ceases to be used exclusively as the taxpayer's primary and permanent residence. According to the consistent position of the Portuguese Tax Authorities, in such cases the sale of the property does not qualify for the reinvestment relief provided for in Article 10(5) of the Personal Income Tax Code, even if the other legal requirements are met.

This interpretation has been confirmed, among others, in Binding Ruling no. 23809, dated 29 December 2023, with the Tax Authorities maintaining that only properties used exclusively as a primary and permanent residence are eligible for this reinvestment regime.

Conclusion

Using the managing shareholder's residence as the company's registered office can be a practical and cost-effective solution, but it requires careful tax planning. The recent position adopted by the Portuguese Tax Authorities creates an opportunity for the deductibility of certain expenses for IRC purposes, provided that formal agreements are in place, allocation criteria are objective and reasonable, and the rules applicable to related-party transactions are respected.

That said, this approach may have significant implications in other tax areas, such as the taxation of capital gains for personal income tax purposes, and should therefore be assessed in a comprehensive and preventive manner.

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