

30. Income tax

The deferred income tax assets and liabilities are analysed as follows:

(Thousands of euros)						
	2019			2018		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Deferred taxes not depending on the future profits (a) (b)						
Impairment losses (c)	983,177	-	983,177	973,317	-	973,317
Employee benefits	836,911	-	836,911	836,580	-	836,580
	1,820,088	-	1,820,088	1,809,897	-	1,809,897
Deferred taxes depending on the future profits						
Impairment losses (c)	822,822	(50,303)	772,519	800,003	(50,303)	749,700
Tax losses carried forward	120,295	-	120,295	328,229	-	328,229
Employee benefits	47,919	(811)	47,108	43,659	(222)	43,437
Financial assets at fair value through other comprehensive income	59,379	(140,103)	(80,724)	157,957	(188,577)	(30,620)
Derivatives	-	(5,640)	(5,640)	-	(6,071)	(6,071)
Intangible assets	49	(663)	(614)	39	-	39
Other tangible assets	11,199	(4,171)	7,028	8,759	(3,184)	5,575
Others	46,711	(17,192)	29,519	24,069	(13,085)	10,984
	1,108,374	(218,883)	889,491	1,362,715	(261,442)	1,101,273
Total deferred taxes	2,928,462	(218,883)	2,709,579	3,172,612	(261,442)	2,911,170
Offset between deferred tax assets and deferred tax liabilities	(207,814)	207,814	-	(255,982)	255,982	-
Net deferred taxes	2,720,648	(11,069)	2,709,579	2,916,630	(5,460)	2,911,170

(a) Special Regime applicable to deferred tax assets

(b) The increase in deferred tax assets not dependent on future profitability results from the merger by incorporation of Banco de Investimento Imobiliário, S.A. into Banco Comercial Português, S.A.

(c) The amounts of 2019 and 2018 include deferred tax assets related with credit impairments non-accepted fiscally of which credits were written-off, according to the expectation that the use of such impairments will be deductible for the purposes of determining taxable income for the tax periods in which the legal conditions required for their tax deductibility are met

As at 31 December 2019, the balance deferred tax assets amounts to Euros 2.720.648.000, of which Euros 2,584,903,000 are related to the Bank's activity. The deferred tax assets related to the Bank's activity includes a net amount of Euros 764,850,000 that depends of the existence of future profitable profits (deferred tax assets not eligible under the special regime applicable to deferred tax assets, approved by Law No. 61/2014, of 26 August), including:

- Euros 657,233,000 related to impairment losses; and

- Euros 109,964,000 resulting from reportable tax losses originating in 2016, with a reporting period of 12 years (until 2028).

Special regime applicable to deferred tax assets

The Extraordinary General Meeting of the Bank that took place on 15 October 2014 approved the Bank's accession to the Special Regime approved by Law No. 61/2014, of 26 August, applicable to deferred tax assets that resulted from not deduction of expenses and negative equity variations with impairment losses on credits and post-employment or long-term employee benefits.

The special regime is applicable to those expenses and negative equity variations recorded in tax periods beginning on or after January 1, 2015, as well as to deferred tax assets recorded in the annual accounts for the last tax period prior to that date and to part of expenses and negative equity variations associated with them. Pursuant to Law No. 23/2016, of 19 August, this special regime is not applicable to expenses and negative equity variations with impairment losses on credits and with post-employment or long-term employee benefits recorded in the periods taxation commencing on or after 1 January 2016, nor to deferred tax assets to these associates.

The special regime applicable to deferred tax assets provides for an optional framework and with the possibility of subsequent waiver, under which:

- Expenses and negative equity variations with impairment losses on credits and with post-employment or long-term employee benefits covered by it are deducted, under the terms and conditions set out in the IRC Code and in relevant separate tax legislation, until the competition taxable profit for the tax period determined before these deductions. Expenses and negative equity variations not deducted as a result of applying this limit are deducted in subsequent tax periods, with the same limit. In the BCP Group, deferred tax assets associated with expenses and negative equity variations under these conditions amount to Euros 1,391,083,000 (31 December 2018: Euros 1,247,052,000).

- In certain situations (those with negative net results in annual individual accounts or liquidation by voluntary dissolution, insolvency decreed by court or revocation of the respective authorization), deferred tax assets covered by the Special Regime are converted into tax credits, in part or in wholeness. In situations of negative net income, the conversion is made according to the proportion between the amount of the negative net income for the period and the total of equity capital, and a special reserve corresponding to 110% of the tax credit must be constituted and, simultaneously, conversion rights attributable to the State of equivalent value, rights that can be acquired by the shareholders upon payment to the State of the same value. Tax credits may be offset against tax debts of the beneficiaries (or an entity based in Portugal within the same prudential consolidation perimeter) or reimbursed by the State.

Pursuant to the regime described, the recovery of deferred tax assets covered by the optional regime approved by Law No. 61/2014, of 26 August, is not dependent on future profits.

The above-mentioned legal framework was densified by Ordinance no. 259/2016, of 4 October, about the control and use of tax credits, and by the Ordinance No. 293-A/2016, of 18 November, which establishes the conditions and procedures for the acquisition by the shareholders of the referred rights of the State. Law No. 98/2019, of 4 September, establishes a deadline for the acquisition of the referred rights of the State by the shareholders, after which the Management Board of the issuing bank is obliged to promote the record of the capital increase by the amount resulting from the exercise of the conversion rights. According to this legislation, among other aspects, these rights are subject to a right of acquisition by the shareholders on the date of creation of the rights of the State, exercisable in periods that will be established by the Board of Directors until 3 years after the confirmation date of the conversion of the deferred tax asset into tax credit by the Portuguese Tax and Customs Authority. The issuing bank shall deposit in favor of the State the amount of the price corresponding to all the rights issued, within 3 months beginning from the confirmation date of the conversion of the deferred tax asset into tax credit. Such deposit shall be redeemed when and to the extent that the rights of the State are acquired by the shareholders, or exercised by the State.

Deferred taxes are calculated based on the tax rates expected to be in force when the temporary differences are reversed, which correspond to the approved rates or substantially approved at the balance sheet date. The deferred tax assets and liabilities are presented on a net basis whenever, in accordance with applicable law, current tax assets and current tax liabilities can be offset with each other and when the deferred taxes are related to the same tax.

The current tax rate for Banco Comercial Português, S.A. is analysed as follows:

	2019	2018
Income tax	21%	21%
Municipal surtax rate (on taxable net income)	1.5%	1.5%
State tax rate (on taxable net income)		
More than 1,500,000 to 7,500,000	3%	3%
From more than 7,500,000 to 35,000,000	5%	5%
More than 35,000,000 (a)	9%	9%

The deferred tax rate related to the Bank's tax losses is 21% (31 December 2018: 21%).

The average deferred tax rate associated with temporary differences of Banco Comercial Português, S.A. is 31.30% (31 December 2018: 31.30%). The income tax rate in the other main countries where the Group operates is 19% in Poland, 32% in Mozambique, 0% (exemption) in the Cayman Islands and 24.16% in Switzerland.

The reporting period of tax losses in Portugal is 12 years for the losses of 2014, 2015 and 2016 and 5 years for the losses of 2017 and following years. In Poland, the term is 5 years, in Mozambique it is 5 years and in Switzerland it is 7 years.

Banco Comercial Português, S.A. applies the Special Tax Regime for Groups of Companies (RETGS) since 2016 for taxation purposes under IRC, in which it's the dominant company.

The balance of Deferred tax assets not depending on the future profits (covered by the regime approved by Law no. 61/2014, of 26 August) includes the amounts of Euros 210,686,000 and Euros 4,020,000 recorded in 2015 and 2016, respectively, related to expenses and negative equity variations with post-employment or long-term employee benefits and to impairment losses in loans accounted until 31 December 2014.

The deferred income tax assets associated to tax losses, by expiry date, are presented as follows:

(Thousands of euros)		
Expiry date	2019	2018
2019-2025	10,306	8,437
2026	-	10,297
2028 and following	109,989	309,495
	120,295	328,229

Following the publication of the Notice of Bank of Portugal No. 5/2015, the entities that presented their financial statements in Adjusted Accounting Standards issued by the Bank of Portugal (NCA), since 1 January 2016 began to apply the International Financial Reporting Standards as adopted in the European Union, including, among others, the Bank's individual financial statements.

As a result of this change, in the Bank's individual financial statements, the loans portfolio, guarantees provided and other operations of a similar nature became subject to impairment losses calculated in accordance with the requirements of International Accounting Standards (IAS 39 until 31 December 2017 and IFRS 9 since 1 January 2018), replacing the registration of provisions for specific risk, for general credit risks and for country risk, in accordance with Bank of Portugal's Notice No. 3/95.

The Regulatory Decrees No. 5/2016, of 18 November, No. 11/2017, of 28 December, and No. 13/2018, of 28 December, established the maximum limits of impairment losses and other corrections of value for specific credit risk that are deductible for the purpose of calculating the taxable profit under IRC in 2016, 2017 and 2018, respectively. These Decrees declare that Bank of Portugal Notice No. 3/95 (Notice that was relevant for determining provisions for credit in the financial statements presented on an NCA basis) should be considered for the purpose of calculating the maximum limits of impairment losses accepted for tax purposes in 2016, 2017 and 2018, respectively.

Law No. 98/2019, of 4 September, establishes the tax regime of credit impairment and of provisions for guarantees for the tax periods beginning on or after 1 January 2019, predicting the approximation between accounting and tax rules for purposes of deductibility of expenses related to the increase of credit impairments. Until the end of 2023, the rules prevailing until 2018 will continue to be applied, except if the option of applying the new regime is exercised earlier.

Regardless the previously referred option, the new regime's application will be mandatory in the financial years of 2022 and/or 2023 in the following circumstances:

- In the financial year of 2022, if, since 1 January 2022, the Bank distributes dividends regarding that financial year or acquires own shares, without occurring a decrease of the deferred tax assets covered by the Special Regime in, at least, 10% comparatively to the amount recorded on 31 December 2018;

- In the financial year of 2023, if, since 1 January 2023, the Bank distributes dividends regarding that financial year or acquires own shares, without occurring a decrease of the deferred tax assets covered by the Special Regime in, at least, 20% comparatively to the amount recorded on 31 December 2018.

For the estimation of taxable income, it was considered the maintenance of the tax rules in force until 2018, resulting from not exercising earlier the option of applying the new regime

In 2018, the Group adopted IFRS 9 - Financial Instruments. Since there is no transitional regime that establishes the tax treatment to be applied to the transition adjustments to IFRS 9, the treatment given resulted from the Bank's interpretation of the application of IRC Code's general rules.

The Group complies with the guidelines of IFRIC 23 - Uncertainty over Income Tax Treatments on the determination of taxable profit, tax bases, tax losses to be reported, tax credits to be used and tax rates in scenarios of uncertainty regarding the income tax treatment, not having occurred material impact on the Bank's financial statements resulting from its application.

Analysis of the recoverability of deferred tax assets

In accordance with the accounting policy 1 Z.3) and with the requirements of IAS 12, the deferred tax assets were recognised based on the Group's expectation of their recoverability. The recoverability of deferred taxes depends on the implementation of the strategy of the Bank's Board of Directors, namely the generation of estimated taxable income and its interpretation of tax legislation. Any changes in the assumptions used in estimating future profits or tax legislation may have material impacts on deferred tax assets.

The assessment of the recoverability of deferred tax assets was carried based on the respective estimated financial statements, prepared under the budgetary process for 2020 and adjusted according to the strategic plan approved by the elected governing bodies, considering the macroeconomic and competitive environment.

To estimate taxable net income for the periods of 2020 to 2028, the following main assumptions were considered:

- It was considered the approximation between accounting and tax rules predicted by Law No. 98/2019, of 4 September, assuming the Group will not exercise its application earlier over the adaptation period of 5 years that the referred Law predicts. In the application of these rules, the following assumptions were considered, in general terms:

a) non-deductible expenses related to increase of credit impairments for the years between 2020 to 2023 were estimated based on the average percentage of non-deducted amounts for tax purposes in the last accounting years between 2016 to 2019, compared to the amounts of net impairment increases recorded in these years;

b) the expenses with credit impairment's increases beginning in 2024 were considered deductible for tax purposes according to the new fiscal regime;

c) impairment reversals not accepted for tax purposes were estimated based on the Reduction Plan of Non-Performing Assets 2019-2021 submitted to the supervisory authority in March 2019, and also on the average reversal percentage observed in the last years of 2016 to 2019;

d) the referred average percentages were calculated separately, according to the presence or not of a mortgage security, the eligibility for the special regime applicable to deferred tax assets and according to the clients' rating as Non-Performing Exposures.

-The deductions related to impairment of financial assets were projected based on the destination (sale or settlement) and the estimated date of the respective operations;

- The deductions related to employee benefits were projected based on their estimated payments or deduction plans, in accordance with information provided by the actuary of the pension fund.

The projections made consider the Group's strategic priorities, essentially reflecting the projection of the Bank's medium-term business in Portugal in terms of results generation, and are globally consistent with the Reduction Plan of Non-Performing Assets 2019-2021, submitted to the supervisory authority in March 2019, emphasising:

- improvement in the net margin, reflecting an effort to increase credit, favoring certain segments, the focus on off-balance sheet resources while interest rates remain negative and the effect of the normalization of those rates in the last years of the projection horizon, such as results from the market interest rate curve;

- increase in commission income based on efficient and judicious management of commissioning and pricing, and, regarding the Individuals segment, the growth of off-balance sheet products;

- normalization of the cost of risk to levels aligned with the current activity of the Bank and reduction of negative impacts produced by the devaluation or sale of non current assets, with the progressive reduction of the historical NPE, foreclosed assets and FREs portfolios;

- capturing efficiency gains enhanced by digitalization, reflected in the control of operating costs, but implying in the short term an effort to adapt the Bank's structure.

- following the analysis of the recoverability of deferred tax assets carried out in 2019, the Bank unrecognized an amount net of deferred tax assets in the amount of Euros 116,347,000, proceeding to the derecognize of deferred tax assets relating to reportable tax losses of Euros 198,565,000 and the recognition of deferred tax assets relating to impairment losses of Euros 82,218,000. From the referred net amount, Euros 69,584,000 were recorded against results and Euros 46,763,000 were recorded against reserves. The allocation of deferred taxes to results and reserves was made in accordance with the accounting principle used for the recognition of the deferred tax assets in question, due to the decomposition of the realities that originated the tax losses to which they refer.

The performed analyse allow the conclusion of total recoverability of the deferred tax assets recognized as at 31 December 2019.

In accordance with these assessments, the amount of unrecognised deferred tax related to tax losses, by expiry year, is as follows:

	(Thousands of euros)	
Tax losses carried forward	2019	2018
2021-2025	182,872	149,694
2026	213,521	203,349
2027 and following	408,679	209,397
	805,072	562,440

The impact of income taxes in Net income and in other balances of Group's equity, as at 31 December 2019, is analysed as follows:

	(Thousands of euros)				
	2019				
	Net income for the year	Reserves	Exchange differences	Euro Bank	Discontinuing operations (c)
Deferred taxes					
Deferred taxes not depending on the future profits (a)					
Impairment losses	9,860	-	-	-	-
Employee benefits	102	229	-	-	-
	9,962	229	-	-	-
Deferred taxes depending on the future profits					
Impairment losses	(19,867)	-	1,148	41,538	-
Tax losses carried forward (b)	(159,768)	(48,201)	35	-	-
Employee benefits	7,022	(4,162)	300	511	-
Financial assets at fair value through other comprehensive income	-	(47,462)	(2,642)	-	-
Derivatives	-	-	431	-	-
Intangible assets	61	-	(4)	(710)	-
Other tangible assets	1,304	-	19	130	-
Others	22,916	5,797	5,312	(10,758)	(4,732)
	(148,332)	(94,028)	4,599	30,711	(4,732)
	(138,370)	(93,799)	4,599	30,711	(4,732)
Current taxes					
Current year	(115,396)	583	-	639	-
Correction of previous years	14,488	-	-	-	-
	(100,908)	583	-	639	-
	(239,278)	(93,216)	4,599	31,350	(4,732)

(a) The increase in deferred tax assets not dependent on future profitability arises from the merger by incorporation of Banco de Investimento Imobiliário, S.A. into Banco Comercial Português, S.A.

(b) Tax on reserves refers to realities recognized in reserves that compete for the purposes of calculating taxable income. The impacts on results and reserves of 2019 include the negative amounts of Euros 9,889,000 and Euros 1,349,000, respectively, resulting from the merger by incorporation of Banco de Investimento Imobiliário, S.A., calculated by reference to 1 January 2019, date that the merger produced its accounting-tax effects (from the perspective of the IRC).

(c) Refers to que sale of Planfipsa.

The impact of income taxes in Net income / (loss) and in other balances of Group's equity, as at 31 December 2018, is analysed as follows:

(Thousands of euros)

	2018			
	Net income / (loss) for the year	Reserves	Exchange differences	
		Impact of adoption of IFRS 9	Changes of the year	
Deferred taxes				
Deferred taxes not depending on the future profits (a)				
Impairment losses	(3,230)	276	(264)	-
Employee benefits	(2,189)	-	-	-
	(5,419)	276	(264)	-
Deferred taxes depending on the future profits				
Impairment losses	(22,005)	(182,551)	370	3,092
Tax losses carried forward (b)	(5,031)	-	11,352	134
Employee benefits	9,862	-	3,461	(108)
Financial assets at fair value through other comprehensive income	(10,076)	33,341	(53,954)	69
Financial assets available for sale	n.a.	(7,070)	n.a.	n.a.
Derivatives	562	-	-	188
Other tangible assets	(824)	-	-	(19)
Others	473	6,373	3,250	(6,049)
	(27,039)	(149,907)	(35,521)	(2,693)
	(32,458)	(149,631)	(35,785)	(2,693)
Current taxes				
Current year	(107,043)	1,047	(963)	-
Correction of previous years	1,484	-	-	-
	(105,559)	1,047	(963)	-
	(138,017)	(148,584)	(36,748)	(2,693)

(a) Deferred tax related to expenses and negative equity variations covered by the special arrangements for deferred tax assets (Law No. 61/2014 of 26 August). Under the Law No. 23/2016 of 19 August, this special scheme is not applicable to expenses and negative equity variations accounted in the taxable periods beginning on or after 1 January 2016, neither to deferred tax assets associated with them.

(b) - The tax on reserves refers to realities recognised in reserves considered for taxable income purposes.

The reconciliation between the nominal tax rate and the effective tax rate is analysed as follows:

(Thousands of euros)

	2019	2018
Net income / (loss) before income taxes	627,266	558,209
Current tax rate (%)	31.5%	31.5%
Expected tax	(197,589)	(175,836)
Employees' benefits	-	1,558
Tax benefits	13,610	14,819
Correction of previous years	12,279	(1,540)
Effect of the difference between the tax rate and deferred tax (a)	38,690	25,321
Effect of recognition / derecognition net of deferred taxes (b)	(85,478)	(1,142)
Other corrections	1,900	1,946
Non-deductible impairment and provisions	(8,779)	(718)
Results of companies accounted by the equity method	13,542	23,875
Autonomous tax	(1,580)	(2,337)
Contribution to the banking sector	(25,873)	(23,963)
Total	(239,278)	(138,017)
Effective rate (%)	38.15%	24.72%

(a) Includes the amount of Euros 15,486,000 related to the effect of updating the deferred tax assets rate on temporary differences transferred by merger of Banco de Investimento Imobiliário, S.A. into Banco Comercial Português, S.A.

(b) Includes the negative amount of Euros 69,584,000 (31 December 2018: negative Euros 14,336,000) related to Banco Comercial Português, S.A. and the effect of the de-recognition of deferred tax assets related to tax losses resulting from the merger of Banco de Investimento Imobiliário, S.A. into Banco Comercial Português, S.A., in the negative amount of Euros 9,889,000.