30. Income tax

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

(Thousands of euros)

	2020			2019		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Deferred taxes not depending on the future profits (a)						
Impairment losses (b)	983,177		983,177	983,177	–	983,177
Employee benefits	836,909		836,909	836,911	–	836,911
	1,820,086	–	1,820,086	1,820,088	–	1,820,088
Deferred taxes depending on the future profits						
Impairment losses (b)	723,864	(50,303)	673,561	822,822	(50,303)	772,519
Tax losses carried forward	176,885	–	176,885	120,295	–	120,295
Employee benefits	55,268	(542)	54,726	47,919	(811)	47,108
Financial assets at fair value through other comprehensive income	38,000	(189,359)	(151,359)	59,379	(140,103)	(80,724)
Derivatives	–	(4,451)	(4,451)	–	(5,640)	(5,640)
Intangible assets	49	–	49	49	(663)	(614)
Other tangible assets	10,992	(4,081)	6,911	11,199	(4,171)	7,028
Others	68,885	(18,745)	50,140	46,711	(17,192)	29,519
	1,073,943	(267,481)	806,462	1,108,374	(218,883)	889,491
Total deferred taxes	2,894,029	(267,481)	2,626,548	2,928,462	(218,883)	2,709,579
Offset between deferred tax assets and deferred tax liabilities	(260,239)	260,239	–	(207,814)	207,814	–
Net deferred taxes	2,633,790	(7,242)	2,626,548	2,720,648	(11,069)	2,709,579

(a) Special Regime applicable to deferred tax assets

(b) The amounts of 2020 and 2019 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 2020, the balance deferred tax assets amounts to Euros 2,633,790,000, of which Euros 2,469,190,000 are related to the Bank's activity. The deferred tax assets related to the Bank's activity includes a net amount of Euros 649,137,000 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 549,477,000 related to impairment losses; and

- Euros 147,819,000 resulting from tax losses carried forward from 2016 and 2020 , which, taking into account the changes established in Law no. 27-A/2020, of July 24, within the scope of the Supplementary Budget for 2020, may be used until 2030 and 2032, respectively.

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 1 January 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 1,471,614,000 (31 December 2019: Euros 1,391,083,000).

- 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 included in the same group of entities for which are applied the Special Tax Regime for Groups of Companies) 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 entity shall deposit in favour 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:

	2020	2019
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	9%	9%

The deferred tax rate related to the Bank's tax losses is 21% (31 December 2019: 21%).

The average deferred tax rate associated with temporary differences of Banco Comercial Português, S.A. is 31.30% (31 December 2019: 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 14% in Switzerland.

In accordance with the amendments provided for in Law No. 27-A/2020, of 24 July, under the Supplementary Budget for 2020, the reporting period for tax losses in Portugal, is now 14 years for the losses of 2014, 2015 and 2016 and 7 years for the tax losses of 2017, 2018 and 2019. The tax losses calculated in 2020 and 2021 have a reporting period of 12 years, which may be deducted until 2032 and 2033 respectively. The limit for the deduction of tax losses is increased from 70% to 80%, when the difference results from the deduction of tax losses determined in the tax periods of 2020 and 2021.

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	2020	2019
2020-2025	29,043	10,306
2028-2029	—	109,989
2030-2032	147,842	—
	176,885	120,295

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.

In the calculation of the taxable income for the year 2019 and in the estimation of taxable income by reference to 31 December 2020 it was considered the maintenance of the tax rules in force until 2018, since the option for the application of the new regime was not exercised.

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 2021 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 2021 to 2033, 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 2021 to 2023 were estimated based on the average percentage of non-deducted amounts for tax purposes in the last accounting years between 2016 to 2020, 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, updated in June 2020 and also on the average reversal percentage observed in the last years of 2016 to 2020;

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;

- Reversals of impairment of non-financial assets not accepted for tax purposes were projected considering the expected periods of disinvestment in certain real estate. For the remaining assets without a forecasted term for disinvestment, the reversals were estimated based on the average percentage of reversal observed in the years from 2016 to 2020. Non-deductible expenses related to the reinforcement of impairment of non-financial assets were estimated on the basis of the average percentage of amounts not deducted for tax purposes in the years from 2016 to 2020, compared to the amounts of reinforcements net of impairment recorded in those years.

- 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 reflect the effects of changes in the macroeconomic, competitive and legal/regulatory framework caused by the COVID-19 pandemic. The Group's strategic priorities remain unchanged, although the achievement of the projected financial results will necessarily suffer a time delay due, on the one hand, to the constraints on the development of activity imposed by the crisis and, on the other, to the impact that the same crisis will have on the credit and other asset portfolios, with immediate repercussions on profitability. To this extent, the projections assume, beyond the initial years of the crisis, a convergence towards medium/long-term metrics and trends consistent with commercial positioning and the ambitious capture of efficiency gains, to which the Group remains committed, with emphasis on:

- improvement in the net margin, reflecting an effort to increase credit, favouring 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.

The performed analyse allow the conclusion of total recoverability of the deferred tax assets recognized as at 31 December 2020.

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	2020	2019
2021-2025	119,413	182,872
2026	42,581	213,521
2027-2029	214,901	408,679
2030-2032	415,785	—
	792,680	805,072

The impact of income taxes in Net income and in other balances of Group's equity, as at 31 December 2020, is analysed as follows:

(Thousands of euros)

	2020		
	Net income for the year	Reserves	Exchange differences
Deferred taxes Deferred taxes not depending on the future profits			
Employee benefits	—	(2)	—
	—	(2)	—
Deferred taxes depending on the future profits			
Impairment losses	(91,910)	—	(7,048)
Tax losses carried forward (a)	42,207	18,198	(3,815)
Employee benefits	4,019	3,133	466
Financial assets at fair value through other comprehensive income	—	(73,369)	2,734
Derivatives	—	—	1,189
Intangible assets	631	—	32
Other tangible assets	(14)	—	(103)
Others	21,740	(10)	(1,109)
	(23,327)	(52,048)	(7,654)
	(23,327)	(52,050)	(7,654)
Current taxes			
Current year	(109,850)	476	—
Correction of previous years	(3,467)	—	—
	(113,317)	476	—
	(136,644)	(51,574)	(7,654)

(a) The amount recorded in reserves refers to the deferred tax on the part of tax loss arising from the deduction of negative equity variations recorded in reserves that contribute to the calculation of taxable income.

The impact of income taxes in Net income / (loss) 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 the sale of Planfipsa.

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

(Thousands of euros)

	2020	2019
Net income / (loss) before income taxes	345,009	627,266
Current tax rate (%)	31.5%	31.5%
Expected tax	(108,678)	(197,589)
Tax benefits	12,963	13,610
Correction of previous years	(787)	12,279
Interests on other equity instruments (a)	11,655	—
Effect of the difference between the tax rate and deferred tax (b)	(11,401)	38,690
Effect of recognition / derecognition net of deferred taxes (c)	(3,010)	(85,478)
Other corrections	(3,464)	1,900
Non-deductible impairment and provisions	(23,966)	(8,779)
Results of companies accounted by the equity method	21,324	13,542
Autonomous tax	(1,097)	(1,580)
Contribution to the banking sector	(30,183)	(25,873)
Total	(136,644)	(239,278)
Effective rate (%)	39.61%	38.15%

(a) Relates to the impact of the deduction, for the purpose of calculating the taxable income, of interests paid related with the perpetual bond, subordinated debt representative, issued on 31 January 2019.

(b) In 2019, includes the amount of Euros 15,486,000 related to the effect of the rate update of deferred tax assets on temporary differences transferred by the merger of Banco de Investimento Imobiliário, S.A. into Banco Comercial Português, S.A.

(c) In 2019, it includes the negative amount of Euros 69,584,000 related to Banco Comercial Português, S.A. and the effect of the derecognition of deferred tax assets related to tax losses resulting from the merger in the negative amount of Euros 9,889,000.