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THE INWARD  
INVESTMENT AND  
INTERNATIONAL  
TAXATION REVIEW

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SEVENTH EDITION

EDITOR  
TIM SANDERS

LAW BUSINESS RESEARCH

# THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

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TIM SANDERS

LAW BUSINESS RESEARCH LTD

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Published in the United Kingdom  
by Law Business Research Ltd, London  
87 Lancaster Road, London, W11 1QQ, UK  
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[www.TheLawReviews.co.uk](http://www.TheLawReviews.co.uk)

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ISBN 978-1-910813-41-6

Printed in Great Britain by  
Encompass Print Solutions, Derbyshire  
Tel: 0844 2480 112

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# ACKNOWLEDGEMENTS

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The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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ABOU JAOUDE & ASSOCIATES LAW FIRM

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AFRIDI & ANGELL

ANDERSON MORI & TOMOTSUNE

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# CONTENTS

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<b>Editor's Preface</b>	.....vii
	<i>Tim Sanders</i>
<b>Chapter 1</b>	BASE EROSION AND PROFIT SHIFTING ..... 1
	<i>Jennifer Wheeler</i>
<b>Chapter 2</b>	AUSTRALIA ..... 10
	<i>Adrian O'Shannessy and Tony Frost</i>
<b>Chapter 3</b>	AUSTRIA..... 25
	<i>Niklas JRM Schmidt and Eva Stadler</i>
<b>Chapter 4</b>	BELGIUM ..... 34
	<i>Christian Chéruy and Marc Dhaene</i>
<b>Chapter 5</b>	BRAZIL..... 64
	<i>Silvania Tognetti</i>
<b>Chapter 6</b>	CANADA ..... 77
	<i>KA Siobhan Monaghan</i>
<b>Chapter 7</b>	CHINA..... 92
	<i>Jon Eichelberger</i>
<b>Chapter 8</b>	CYPRUS ..... 107
	<i>Georgia Papa</i>
<b>Chapter 9</b>	DENMARK ..... 122
	<i>Jakob Skaadstrup Andersen</i>
<b>Chapter 10</b>	ECUADOR..... 136
	<i>Alejandro Ponce Martínez</i>



<b>Chapter 11</b>	FRANCE .....	149
	<i>Philippe Derouin</i>	
<b>Chapter 12</b>	GREECE.....	174
	<i>Aspasia Malliou and Maria Kilatou</i>	
<b>Chapter 13</b>	HONG KONG .....	189
	<i>Steven Sieker and Wenwen Chai</i>	
<b>Chapter 14</b>	INDONESIA .....	200
	<i>Mulyana, Sumanti Disca Ferli and Bobby Christianto Manurung</i>	
<b>Chapter 15</b>	IRELAND.....	216
	<i>Peter Maher</i>	
<b>Chapter 16</b>	ISRAEL.....	236
	<i>Meir Linzen</i>	
<b>Chapter 17</b>	ITALY .....	250
	<i>Paolo Giacometti and Giuseppe Andrea Giannantonio</i>	
<b>Chapter 18</b>	JAPAN .....	268
	<i>Kei Sasaki, Fumiaki Kawazoe and Kobei Kajiwara</i>	
<b>Chapter 19</b>	LEBANON .....	284
	<i>Souraya Machnouk, Hachem El Housseini and Ziad Maatouk</i>	
<b>Chapter 20</b>	LUXEMBOURG.....	297
	<i>Pieter Stalman and Chiara Bardini</i>	
<b>Chapter 21</b>	MALTA.....	314
	<i>Juanita Brockdorff and Michail Tegos</i>	
<b>Chapter 22</b>	MEXICO .....	325
	<i>Eduardo Barrón and Carl E Koller Lucio</i>	
<b>Chapter 23</b>	NETHERLANDS .....	348
	<i>Paulus Merks and Sebastian Frankenberg</i>	

<b>Chapter 24</b>	NIGERIA .....	363
	<i>Theophilus I Emuwa, Chinyerugo Ugoji, Adefolake Adewusi and Mutiat Adeyemo</i>	
<b>Chapter 25</b>	NORWAY .....	374
	<i>Thomas E Alnæs and Erik Landa</i>	
<b>Chapter 26</b>	PERU .....	387
	<i>César Castro Salinas and Rodrigo Flores Benavides</i>	
<b>Chapter 27</b>	POLAND .....	403
	<i>Jarosław Bieroński</i>	
<b>Chapter 28</b>	PORTUGAL .....	433
	<i>José Pedroso de Melo</i>	
<b>Chapter 29</b>	PUERTO RICO .....	449
	<i>Miguel A Santiago Rivera and Alberto J E Añeses Negrón</i>	
<b>Chapter 30</b>	SPAIN .....	470
	<i>Javier Hernández Galante and Ricardo García-Borregón Tenreiro</i>	
<b>Chapter 31</b>	SWEDEN .....	489
	<i>Carl-Magnus Ugglå</i>	
<b>Chapter 32</b>	TAIWAN .....	502
	<i>Michael Wong and Dennis Lee</i>	
<b>Chapter 33</b>	THAILAND .....	512
	<i>Panya Sittsakonsin and Sirirasi Gobpradit</i>	
<b>Chapter 34</b>	UNITED ARAB EMIRATES .....	525
	<i>Gregory J Mayew and Silvia A Pretorius</i>	
<b>Chapter 35</b>	UNITED KINGDOM .....	541
	<i>Tim Sanders</i>	

<b>Chapter 36</b>	UNITED STATES.....	564
	<i>Hal Hicks, Moshe Spinowitz and Robert C Stevenson</i>	
<b>Chapter 37</b>	VENEZUELA .....	588
	<i>Alberto Benshimol and Humberto Romero-Muci</i>	
<b>Chapter 38</b>	VIETNAM.....	603
	<i>Fred Burke and Nguyen Thanh Vinh</i>	
<b>Appendix 1</b>	ABOUT THE AUTHORS.....	617
<b>Appendix 2</b>	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	639

# EDITOR'S PREFACE

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2016 saw dramatic change in the tax landscape in which international business is conducted. Most of this change revolved around the rollout of base erosion and profit shifting (BEPS) following the endorsement of the reports containing the 15-point action plan by the G20 leaders in November 2015, both in terms of its adoption in domestic tax laws and follow-up action by the EU Commission.

As well as the implementation of BEPS, 2016 also saw the European Commission adopting an increasingly aggressive use of state aid laws to attack the application by Member States of their domestic tax laws and the tax rulings they issue to multinational taxpayers operating across international borders. Many observers are concerned that the European Commission has crossed a fine line and is imposing its authority over Member States' sovereign right to determine their own direct taxes. On a more practical level, the European Commission's approach has drawn expressions of concern from the US Treasury on the basis, *inter alia*, that the Commission's approach is inconsistent with international norms, and that it undermines the international tax system and the BEPS initiative. It will be interesting to see where this potential conflict between the US Treasury, supported by certain EU Member States (notably Ireland, which is contesting the findings in the *Apple* case), and the European Commission, goes in 2017.

Despite the uncertainty so much radical change produces, enterprises will continue to trade across borders and establish a presence in jurisdictions beyond the boundaries of their home state. When doing so they will look to the tax adviser for guidance and confirmation of their tax position. While it is beyond any book to provide all the answers, it is hoped that this volume will prove to be a useful starting point for readers. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions with a chapter on the overarching potential impact of BEPS. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors, and not those of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest available intelligence.

**Tim Sanders**

London

January 2017

## Chapter 28

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# PORTUGAL

*José Pedroso de Melo*<sup>1</sup>

### I INTRODUCTION

The Portuguese tax system is composed of several state and municipal taxes that may have a significant impact on investment decisions and the way in which businesses should be structured in an efficient manner. State taxes comprise taxes on companies' and individuals' income (corporate income tax (CIT), personal income tax and social contributions), taxes on expenditure (VAT and excise duties) and others (including stamp tax). Municipal taxes are levied on the ownership and sale of immoveable property (municipal property tax and property transfer tax).

Several important reforms carried out over recent years have successfully put Portugal on the map for tax competitiveness regarding inward investment.

Besides a very attractive corporate tax regime, Portugal offers a wide range of tax incentives and planning opportunities for foreign companies and individuals who wish to settle in, or to invest in and through, the country.

Along with a very modern and competitive tax environment, Portugal offers a whole tranche of other compelling factors for consideration by potential investors, such as, to mention just a few, workforce education and skills, qualified labour availability, a modern labour law, infrastructure, cost of real estate, R&D capability and access to Portuguese-speaking countries.

### II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

#### i Corporate

Under Portuguese law, there is a choice of different legal forms for establishing a business, from sole trader to various types of companies, as defined in the Companies Code.

---

<sup>1</sup> José Pedroso de Melo is a managing associate at SRS Advogados.

Five types of entity are listed in the Companies Code:

- a* partnerships;
- b* private limited companies;
- c* single-member private limited companies;
- d* public limited liability companies; and
- e* limited partnerships (simple or limited by shares).

Of the various entities on offer under Portuguese law, the two most commonly used are the private limited company and the public limited liability company. The choice of business entity is dependent on several factors: the desired degree of simplicity, both in terms of structure and operation; the minimum amount of paid-in capital required; and confidentiality issues relating to the ownership of capital.

In a public limited liability company, the liability of each shareholder is limited to the value of his or her shareholding. The minimum number of shareholders for the incorporation of this type of company is five, and the capital is divided into shares.

Private limited companies are the most common type of company in Portugal. This is the preferred model for small and medium-sized companies, given its great flexibility.

## **ii Non-corporate**

For CIT purposes, partnerships are subject to the same treatment as companies, although a fiscal transparency regime applies to certain resident entities: civil law companies not incorporated in commercial form; incorporated firms of professionals; and holding companies the equity of which is controlled, directly or indirectly, for more than 183 days, by a family group or a limited number of members.

A fiscal transparency regime also applies to ACEs (complementary business groupings) and European economic interest groupings treated as resident in Portugal.

## **III DIRECT TAXATION OF BUSINESSES**

### **i Tax on profits**

#### *Determination of taxable profit*

Taxable profit is calculated on the basis of accounting income adjusted according to specific rules contained in Portuguese tax legislation.

Business expenses are generally tax-deductible provided that they are incurred in generating taxable profits or deemed essential for maintaining the structure of the company. Nonetheless, some expenses are not deductible for the purpose of computing taxable profits, even where accounted for as costs or losses in the relevant accounting period. That is the case, for example, in relation to the following items:

- a* CIT paid;
- b* compensation paid in respect of insurable events;
- c* *per diem* expense allowances and payments relating to an employee's travel using his or her own car, under certain circumstances;
- d* excessive depreciation and accounting provisions; and
- e* interest and other forms of remuneration from shareholder loans exceeding certain limits.

Intangible assets without a fixed life cycle acquired on or after 1 January 2014 may be depreciated over a 20-year period (5 per cent per year) counted from the initial recording of the asset in the company's books. This regime applies to the following intangible assets: industrial property such as trademarks, licences, production processes, models and other similar rights acquired for consideration and without a fixed life cycle; and goodwill arising from business restructuring transactions (but excluding goodwill arising from share transactions).

### *Capital and income*

The CIT Code adopts a wide definition of taxable income, and capital gains are treated as ordinary business profits and taxed accordingly.

Capital gains and capital losses on the sale of a company's assets, other than those exempt under the participation exemption regime (see below), are computed as the difference between the proceeds of disposal, net of related expenditure, and the acquisition cost, reduced by any depreciation claimed.

Only 50 per cent of the difference between capital gains and losses is taken into account where, in the year prior to the disposal or before the end of the second following year, the disposal proceeds are reinvested in the acquisition, manufacture or construction of tangible fixed assets, non-consumable biological assets or investment properties, but with the exception of second-hand assets acquired from related parties.

### *Losses*

Tax losses may be carried forward for five years, although any deduction is limited to 70 per cent of the taxable profit assessed in the relevant fiscal year.

Losses carried forward may be lost if, between the tax year in which the losses were suffered and the year in which they are used, there is a change in the object or the activity effectively performed by the company, or 50 per cent (or more) of its share capital is transferred to different shareholders, except when:

- a* there is a change from direct to indirect ownership (and vice versa);
- b* the special tax-neutrality regime is applicable to the transaction;
- c* the change of ownership occurs upon the death of the previous shareholder;
- d* the acquirer holds, directly or indirectly, 20 per cent of the share capital or the majority of voting rights, at the minimum from the beginning of the tax year in which the tax losses were incurred; or
- e* the acquirer is an employee or a board member of the acquired company, provided that such person holds that position (at the minimum) from the beginning of the tax year in which the tax losses were incurred.

### *Rates*

The regular CIT rate in Portugal is 21 per cent. The tax rate applicable to the first €15,000 of the taxable income of taxpayers qualifying as small and medium-sized enterprises, as provided by EU Commission Recommendation 2003/361/EC, is 17 per cent. A municipal surcharge is levied in addition to CIT in most municipalities at a rate of up to 1.5 per cent of taxable income.

Corporate taxpayers with taxable income of more than €1.5 million are also subject to a state surcharge of 3 per cent. The surcharge increases to 5 per cent for taxable income exceeding €7.5 million, and to 7 per cent for taxable profits in excess of €35 million.



### *Administration*

#### *Filing tax returns*

CIT assessment returns must be filed by Portuguese-resident entities and permanent establishments of non-resident companies and submitted by 31 May following the end of the calendar year, or five months after the authorised year-end if the company's tax year does not follow the calendar year. An annual return containing simplified corporate information must also be filed by 15 July or by the 15th day of the seventh month following the end of the tax year.

Taxable persons liable to CIT and their representatives must also file statements in respect of registrations, changes or cancellations on the register of taxable persons, and are required to keep a tax documentation file in respect of each accounting period for a 10-year period containing all accounting and tax information.

#### *Tax authorities*

Taxes in Portugal are administered by the Portuguese Tax and Customs Authority, which is organised as a vertical structure integrated into the Ministry of Finance and divided into two main services: the Directorate General for Taxation and the Directorate General for Customs and Excise Taxes.

The Tax Authority has competence to carry out tax audit procedures, make additional and late interest tax assessments, and impose penalties and fines on non-compliant taxpayers.

#### *Advance rulings*

To reduce ambiguities, taxpayers may request advance rulings regarding their tax affairs, including their eligibility for tax benefits. When advance rulings are issued, the tax authorities may not derogate from such rulings in relation to the taxpayers that requested it, except pursuant to court decisions.

By request of the applicant, and subject to the payment of a fee, an advance ruling may be provided urgently (within 90 days), provided that such request is accompanied by a tax framework proposal. The proposed tax framework and the facts to which the urgent request for an advance ruling relate are considered tacitly sanctioned by the tax authorities if the request is not answered within 90 days.

Non-urgent rulings are delivered within 150 days.

Apart from the advance ruling regime, a taxpayer and the Portuguese Tax Authority may negotiate advance pricing agreements on transfer pricing issues.

#### *Means of appeal*

Following a tax audit, the taxpayer is allowed to challenge an additional tax assessment made by the tax authorities, either by means of an administrative claim submitted to the tax authorities, or through a judicial or arbitration appeal to the tax courts or to the tax arbitration court.

Decisions of the tax courts may be appealed to the Central Administrative Court of Appeal or to the Administrative Supreme Court.

#### *Tax grouping*

Portuguese-resident companies that are members of an economic group may opt to be taxed under the special group taxation regime.

The parent must hold, directly or indirectly, for a minimum one-year period, at least 75 per cent of the subsidiaries' share capital and 50 per cent of their voting rights. All

companies in the group must be tax-resident in Portugal (albeit indirectly held, through an EU or EEA resident company), and must be subject to Portuguese CIT on their worldwide income at the standard CIT rate to benefit from this regime. This regime is also applicable if the parent company has a permanent establishment in Portugal that holds the capital of the subsidiaries, and some other cumulative conditions are met.

Entities with tax losses in the preceding three years are not eligible for this regime, except where their share capital has been held by the parent for more than two years.

## ii Other relevant taxes

### *Value added tax (VAT)*

Portuguese VAT legislation basically follows the EU common system of VAT. It applies to the supply of goods, services, and intra-Community acquisitions and imports into the Portuguese territory.

Any person or corporate entity that independently carries out an economic activity, or that carries out a single taxable transaction either in connection with the performance of the above-mentioned activities or that is subject to personal tax or CIT, is liable to charge VAT on every supply it makes in the scope of its activities, and afterwards to deliver the due amount to the tax authorities.

There are three VAT rates: 23 per cent (standard), 13 per cent (intermediate) and 6 per cent (reduced).

In the autonomous regions of Azores and Madeira, the VAT rates are currently reduced to 18 and 22 per cent (standard), 9 and 12 per cent (intermediate), and 4 and 5 per cent (reduced), respectively.

### *Property transfer tax (IMT)*

IMT is levied on the onerous transfer of immoveable property.

The tax is payable by the purchaser, whether an individual or a company, resident or non-resident. The taxable amount corresponds to the higher of the contractual price or the patrimonial tax value.

The tax due is assessed as described above at the following tax rates:

- a* rural property: 5 per cent;
- b* urban property and other acquisitions: 6.5 per cent;
- c* urban property for residential purposes: progressive tax rates ranging from zero to 6 per cent; and
- d* rural or urban property where the purchaser is domiciled in a blacklisted jurisdiction: 10 per cent.

### *Local property tax (IMI)*

IMI is levied annually on immoveable property located within each municipality. The tax is payable on the taxable value by the owner of the property as of 31 December of each year, to be paid in two instalments in the following year.

The taxable value of urban property corresponds to the patrimonial tax value recorded on the tax registry.

The IMI rates are as follows:

- a* rural property: 0.8 per cent;
- b* urban property: 0.3 to 0.45 per cent; and

- c rural or urban property where the owner is domiciled in a blacklisted jurisdiction: 7.5 per cent.

### *Stamp tax*

Stamp tax is generally charged on certain formal acts and documents, such as transfers of title and contracts, which are signed or take place on Portuguese territory and which are not subject to VAT, as outlined in the General Table of Stamp Tax.

Loans granted to resident entities, regardless of the nature or place of domicile of the lender, are generally subject to stamp duty ranging from 0.04 to 0.6 per cent, depending on the term of the credit or loan given. A tax exemption may be granted to the following operations provided certain requirements are met: long-term loans qualifying as *suprimentos*<sup>2</sup> for Portuguese commercial law purposes, made by a shareholder to a company, provided that the participation exemption requirements are met concerning the level of participation and detention period; and short-term (less than one year) cash management loans made by parent companies to their subsidiaries.

## **IV TAX RESIDENCE AND FISCAL DOMICILE**

### **i Corporate residence**

Companies are deemed to be resident in Portugal for tax purposes if their head office or place of effective management (regardless of the head office's jurisdiction) is located on Portuguese territory. These two criteria are often met simultaneously, providing consistency under tax law. However, where this is not the case, the place of effective management is the decisive factor.

According to Portuguese case law, the place of effective management is defined as the place where the management decision-making takes place, and where adequate substance (in the form of both people and real estate) exists.

Resident companies are taxed on their worldwide income. Non-resident companies are taxed on their Portuguese-source income.

### **ii Branch or permanent establishment**

In general terms, domestic branch profits are taxed on the same basis as corporate income. Nevertheless, there are some differences in tax treatment (general administrative expenses incurred by the head office may be allocated to the branch, and there may be certain restrictions concerning the deductibility of certain expenses charged by the head office to the branch).

All income is included in the tax base, regardless of its geographical source, provided that such income is attributable to the permanent establishment located in the Portuguese territory. All allowable items of expenditure, deductions and credits are also taken into account, regardless of the source of the income to which such items relate, with the same requirement mentioned above.

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2 A legal concept for shareholder loans with a deadline for repayment of over one year.

## **V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT**

### **i Special tax regime for non-habitual residents**

The non-habitual residents regime is available for citizens who have become Portuguese residents for tax purposes, according to the criteria defined by the PIT Code, and who have not been deemed resident in Portugal in any of the previous five years. The non-habitual residents regime is applicable for 10 consecutive years, under the condition of being considered as a resident during that period. If a taxpayer does not meet the requirements to be considered as resident in any year or years within that period (thus not using the complete period), the taxpayer may resume the use of this regime as soon as he or she meets the requirements.

As this regime only sets forth a different type of residency, the non-habitual resident's income will be subject to tax in Portugal on a worldwide basis taking into consideration the following features:

- a* Portuguese income obtained from highly added value activities of a scientific, artistic or technical nature is taxed at a special rate of 20 per cent. These activities are defined in Ordinance No. 12/2010 of 7 January, and include architects, engineers and similar professionals, visual artists, actors and musicians, auditors, doctors and dentists, teachers (psychologists, liberal professionals, technicians and the like), and investors, managers and directors.
- b* The exemption method for the elimination of double taxation will be applicable on income derived from foreign sources in categories A (employment), B (self-employment), E (capital income), F (real estate income) and G (assets).

The exemption method only applies to employment income (category A) obtained abroad by non-habitual residents when one of the following requirements is met: the income is taxed by the source state, according to the convention to eliminate double taxation celebrated between Portugal and the other country; or the income is taxed in another country, when the two states have not agreed any convention, as long as the income has not deemed as obtained on Portuguese territory.

Self-employment (category B) income obtained through highly added value activities and those classified as categories E, F and G, obtained by non-habitual residents are exempt if, alternatively, they can be taxed in the source state, according to the tax convention celebrated between Portugal and the other country; or they can be taxed in another country, as long as this territory is not subject to privileged tax systems (as defined in Ordinance No. 292/2011, 8 November) and the corresponding income has not been obtained in Portugal.

Regarding pensions (category H) income derived from foreign sources, Portuguese non-habitual residents are exempt if that income is taxed in the source state or if the income cannot be regarded as obtained on Portuguese territory.

### **ii Participation exemption for dividends and capital gains**

Profits and reserves distributed to Portuguese-domiciled companies by their subsidiaries and the capital gains and losses arising from the sale of shareholdings in such subsidiaries are not subject to CIT, provided that:

- a* the Portuguese company holds at least 10 per cent of the share capital or voting rights of the subsidiary;

- b* the shares have been held for at least 12 months prior to the distribution or transfer of the shares (or if the shares are maintained for that period, in the case of distribution of profits);
- c* the company distributing the dividends or reserves is subject to and not exempt from Portuguese CIT, similar tax referred to in the Parent–Subsidiary Directive or similar tax provided that its applicable rate is not lower than 60 per cent of the Portuguese standard CIT rate, unless:
  - at least 75 per cent of the profits derive from an agricultural, industrial or commercial activity, or from the rendering of services that are not predominantly targeted to the Portuguese market;
  - the entity distributing the profits or the reserves, or in which a shareholding is sold, does not have a residence and is not domiciled in a blacklisted jurisdiction;
- d* the company distributing the dividends or reserves, or whose capital is subject to sale, is not domiciled in a blacklisted jurisdiction; and
- e* the profits or reserves do not qualify as deductible costs in the distributing entity.

Under the same universal principle of double taxation relief, companies with a registered office or effective centre of management in Portugal may exclude from their taxable base earnings and losses attributable to permanent establishments located outside Portugal, provided that the following conditions are met: the permanent establishment is subject to and not exempt from a rate of tax not less than 60 per cent of the CIT rate in the state of its location; and the permanent establishment is not located in a blacklisted jurisdiction.

### **iii Patent box**

Income arising from the sale or temporary use of patents and industrial designs registered on or after 1 January 2014 may benefit from a 50 per cent exemption, provided that:

- a* the assignee uses the industrial property rights in the pursuit of an activity of a commercial, industrial or agricultural nature;
- b* the transferee of the rights does not use them for the delivery of goods or services that create tax-deductible expenses in the transferor company or in a company with which the transferor is grouped, whenever a special relationship is deemed to exist;
- c* the assignee is not resident in a blacklisted territory; and
- d* the accounting records of the taxpayer are organised in such a way as to allow the identification of the costs and losses directly attributable to the industrial property right subject to the assignment or temporary use.

### **iv State aid**

National and foreign companies that intend to invest in Portugal in certain sectors of activity may apply for financial incentives granted by EU structural funds under the National Strategic Reference Framework.

Apart from such financial incentives, eligible productive investment projects set up by 31 December 2020 may also benefit from certain contractual tax incentives under the Tax Investment Code, such as CIT credits, or real estate and stamp tax reductions or exemptions. This regime complies with the EU state aid rules.

v **General**

Apart from the exemptions from withholding tax on outbound payments granted under the CIT Code (see below), there are some other notable tax incentives provided in the Portuguese Tax Benefits Statute and ancillary legislation.

*Madeira free zone*

Companies licensed to operate under the scope of the Madeira International Business Centre benefit from extremely attractive tax benefits, such as a reduced CIT rate of 5 per cent until 2027 (except for intragroup services, financial intermediation and insurance), and exemptions from stamp duty and from property transfer tax and municipal property tax in relation to real estate located in Madeira and registered for company business use, depending on the date of the licence. Shareholders of the companies covered by the scheme, both individuals and companies, may benefit from income tax exemption on dividends and interests paid out.

*Undertakings for collective investment (UCIs)*

Following a Corporate Income Tax Reform Commission recommendation, a new tax framework for UCIs was approved with effect from 1 July 2015.

The regime applies to Portuguese UCIs only, including:

- a* securities investment funds (SIFs);
- b* real estate investment funds (REIFs);
- c* securities investment companies (SICs); and
- d* real estate investment companies (REICs).

Under the new regime, UCIs have become subject to CIT on their net profit, which, however, does not include dividends, interest, rental income and capital gains. Instead compensation, UCIs are subject to stamp tax on their global net asset value, which is due on a quarterly basis. The tax rates are as follows: 0.0025 per cent for UCIs investing only in money market instruments and deposits; and 0.0125 per cent for other types of UCIs (including real estate funds and companies).

The taxation of non-resident investors will depend on the type of UCI to which the income relates.

Income arising from SIFs and SICs, including income distributed by these entities, capital gains from the disposal of units or shares, or income arising from the redemption of units, is fully exempt from tax in Portugal.

Income arising from REIFs and REICs, including income distributed by these entities, capital gains from the disposal of units or shares, or income arising from the redemption of units, is subject to a 10 per cent flat rate tax in Portugal. Furthermore, income arising from REIFs and REICs, including capital gains from the disposal of units or shares and income arising from their redemption, shall be considered as income from immovable property (i.e., shall qualify under Article 6 of the OECD Model Tax Convention).

When more than 25 per cent of non-resident entities are directly or indirectly held by Portuguese residents, or are located in blacklisted jurisdictions, they are subject to tax on all income arising from UCIs at a rate of 25 or 35 per cent, respectively.

*Job creation tax credit*

A tax credit may be granted to Portuguese-based companies hiring young employees (less than 35 years old) and the long-term unemployed.

*Capital gains realised by non-resident entities*

Capital gains from the transfer of shares, warrants and other securities issued by Portuguese-resident entities and realised by non-resident entities are income tax-exempt. This exemption does not apply to the following:

- a* non-resident entities, at least 25 per cent of whose equity is directly or indirectly owned by resident entities, except:
  - if they are resident in a state that is an EU Member State, an EEA Member State if bound to similar fiscal cooperation obligations, or any state that has concluded a double tax treaty that includes a provision ensuring exchange of tax information;
  - if they are subject to and not exempt from a tax referred to in the Parent–Subsidiary Directive or similar tax whose nominal rate is not lower than 60 per cent of the Portuguese nominal CIT rate;
  - if they hold, directly or indirectly, at least 10 per cent of the equity or voting rights of the divested entity;
  - if they hold the equity for a 12-month period prior to the disposal; or
  - if they are an operation whose main or principal purpose is to obtain a tax advantage;
- b* entities domiciled in a blacklisted territory; and
- c* capital gains realised by non-resident entities on the sale of shares in the capital of a company resident in Portugal, at least 50 per cent of whose assets are made up of real estate situated on Portuguese territory.

## **VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS**

### **i Withholding outward-bound payments (domestic law)**

Except in certain circumstances, most income obtained by non-resident entities in the Portuguese territory is subject to withholding tax. Income is deemed to be obtained in Portugal if the debtor is a resident, or has its head office or place of effective management, in Portugal, or if its payment is attributable to a permanent establishment in Portugal.

The CIT withholding tax rate is generally 25 per cent.

### **ii Exemption on outbound payments**

Outbound dividends paid by Portuguese-domiciled companies are exempt from withholding tax, providing that the company receiving the dividends:

- a* is resident in a Member State of the EU or EEA, or a country with which Portugal has concluded a double tax treaty that includes a provision for administrative cooperation in the field of taxation similar to that existing in the EU;
- b* is subject to and not exempt from a tax mentioned in the EU Parent–Subsidiary Directive, or a tax that is similar to CIT tax, in other cases, provided that the applicable tax rate is not less than 60 per cent (12.6 per cent) of the CIT rate; and
- c* has held, directly or indirectly, for a 12-month period prior to the distribution a participation of at least 10 per cent of the share capital or voting rights of the company.

In the event that the 12-month period is not completed, dividends paid will be subject to a 25 per cent withholding tax (which can be recovered after the completion of such period) eventually reduced under an applicable tax treaty.

Interest paid by Portuguese-domiciled subsidiaries to a parent company that is a resident in an EU Member State may benefit from a withholding tax exemption under the EU Interest and Royalties Directive provided that:

- a* both companies are incorporated under a legal form foreseen in the Annex to the Directive;
- b* both companies are subject to tax on income without the possibility of being exempt;
- c* there is a direct participation of 25 per cent or more between the companies, or a share of 25 per cent or more of both companies is owned by a third company that complies with the above conditions; and
- d* in either case, the subsidiary is held for a minimum of two years.

### **iii Double tax treaties**

In addition to Portuguese domestic arrangements that provide relief from international double taxation, Portugal has entered into double taxation treaties with 77 countries to prevent double taxation, 68 of which are already in force.

Under these treaties, withholding tax rates on outbound dividend, interest and royalty payments are reduced wherever the beneficial owner of the income derived from Portugal is a tax resident of the other contracting state. For a detailed list of the tax treaties in force and rates applicable to interest, royalties and dividends, see Appendix I.

### **iv Taxation on foreign-sourced income**

Residents who receive foreign-sourced income are entitled to a tax credit equal to the lower of the foreign tax paid or the Portuguese tax payable on such income. The credit applies to income derived from treaty and non-treaty countries; however, for treaty countries, the credit is limited to the amount of tax payable in the source country under such treaty.

Under the domestic participation exemption regime, dividends from qualifying holdings paid to Portuguese tax-resident parent companies may benefit from a CIT exemption (see above).

## **VII TAXATION OF FUNDING STRUCTURES**

### **i Thin capitalisation**

The former thin capitalisation rules were abolished on 1 January 2013, and replaced by specific limitations on the tax deductibility of interest expenses.

Under the new rules, net financial costs are only deductible up to €1 million or 30 per cent of the earnings before interest, taxes, depreciation and amortisation.

The 40 per cent threshold will be reduced by 10 percentage points annually until it reaches 30 per cent in 2017. The non-deductible excess, as well as the unused fraction of the threshold, may be carried forward for the following five years.

Furthermore, in respect of shareholder loans, deductible interest cannot exceed the 12-month Euribor rate in force on the day the loan was granted, plus a 2 per cent spread. This limitation does not apply where transfer pricing rules are applicable.

### **ii Restrictions on payments**

Under the Portuguese Commercial Companies Code, the payment of dividends or reserves to shareholders is disallowed in the following situations: where any profit is needed to cover



accrued losses or to rebuild legal or statutory reserves; incorporation and R&D expenses are not fully depreciated, unless the amount of the free reserves and retained earnings is at least equal to non-depreciated expenses; or where the company's net equity is less than the sum of its share capital and reserves.

### iii Return of capital

Companies may return cash to shareholders by means of a dividend distribution, capital reduction, redemption of shares or liquidation.

A payment to shareholders in connection with a reduction of capital along with redemption of shares is regarded for tax purposes as a capital gain on any value exceeding the purchase price of the shares.

Liquidation proceeds are deemed to be capital gains or capital losses that are eligible for the participation exemption regime.

## VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

### i Acquisitions

Business acquisitions are usually structured as either asset or share deals.

The main difference between asset and share deals is the type of tax treatment. There are various taxes that can be either levied on the acquisition of assets (property transfer tax, VAT or stamp tax) depending on the nature of the assets. On the other hand, the obtaining of taxable capital gains is less likely on a sale of shares.

The acquisition of shares of a public limited liability company is not subject to VAT or property transfer tax. The acquisition of shares of a private limited company, of a general partnership or of a partnership association is subject to IMT where these entities hold property and where, following the share acquisition, one of the shareholders will hold at least 75 per cent of the share capital, or the number of shareholders will reduce to two, with these two individuals being spouses married under the regime for general community property.

Capital gains realised by non-resident entities on the transfer of shares of Portuguese companies are not exempt from income tax if more than 50 per cent of the assets of the sold company consists of real estate situated on Portuguese territory (see above).

### ii Reorganisations

Restructuring operations such as mergers, demergers, spin-off transactions, transfers of assets and share exchanges may be performed without income tax constraints for companies and shareholders involved under the Portuguese fiscal neutrality regime.

The fiscal neutrality regime covers only CIT and PIT. However, exemptions from property transfer tax, stamp tax and notarial and registration fees may be granted by the Ministry of Finance upon request, provided that certain conditions are met by the restructuring operation.

### iii Exit charges

When a company transfers its tax residence abroad, the company is deemed liquidated and is subject to CIT on the positive difference between the market value and the book value of its assets, provided that these are not allocated to a permanent establishment of the company in

Portugal. The same regime applies on the cessation of activity of a permanent establishment of a non-resident entity located in Portugal and to the transfer outside Portuguese territory, by any act or legal instrument, of assets allocated to that establishment.

The tax liability resulting from the transfer of residence can be deferred where the transfer is made to an EU or EEA Member State, provided that certain conditions are met.

## **IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION**

### **i General anti-avoidance**

Portuguese general anti-avoidance rules provide for a general principle of substance over form under which the tax authorities may disregard the legal form agreed upon by the parties where a transaction is deemed exclusively or principally tax-driven, and they may recharacterise the facts for tax purposes in accordance with the underlying economic reality.

### **ii Controlled foreign corporation (CFC) rules**

Under the CFC rules, profits or other income derived by non-residents in the Portuguese territory and subject to a more favourable tax regime can be attributed to Portuguese-resident shareholders who hold, directly or indirectly, at least 25 per cent of the share capital (or 10 per cent if more than 50 per cent of the share capital of the non-resident company is held, directly or indirectly, by Portuguese-resident shareholders) in proportion to their shareholding.

### **iii Transfer pricing**

Portugal has implemented detailed transfer pricing legislation that broadly follows the methodologies and principles in the OECD guidelines.

Under Portuguese transfer pricing rules, domestic and cross-border inter-company transactions must be at arm's length, and the Portuguese tax authorities have wide-ranging powers to adjust declared income if they consider that market conditions have not been respected.

Special relations are deemed to exist between two entities where one such entity has the power to exercise, directly or indirectly, a significant influence on the management decisions of the other entity.

All companies undertaking transactions with related entities, even if they are not obliged to prepare a transfer pricing file, have to fill out additional declarations as part of their annual tax reporting obligations.

Additionally, taxpayers with annual net sales and other income equal to or greater than €3 million in the fiscal year prior to the year under consideration are required to prepare a transfer pricing file, which should contain an analysis of all of the aspects of every transaction with related parties.

### **iv Tax clearances and rulings**

Upon request, tax and social security authorities may deliver a written confirmation that a company's tax affairs are in order. These certificates are valid for three months.

Binding advance rulings may be awarded in specific situations (see above).

## X YEAR IN REVIEW

Following the deep reforms carried out recently, and despite political instability, 2016 was relatively stable with regards to the essential aspects of the taxation of companies and individuals.

Notwithstanding, a very challenging political situation has unfortunately led to three significant setbacks to some of the flagship measures regarding CIT, such as the maintenance of the nominal tax rate (that was supposed to be reduced to 19 per cent), the reduction, from 12 to five years, of the tax loss carry-forward period, and the increase, from 5 to 10 per cent, of the minimum participation required for the participation exemption regime.

## XI OUTLOOK AND CONCLUSIONS

In line with recent years, 2016 was marked by an increase of inward investment, although most of it is real estate-driven.

The result of the November 2015 general elections plunged the country into a considerable uncertainty, although it is not expected any relevant shift in what regards to the key aspects of the tax system. Even so, the Draft State Budget for 2017 recently presented to the Parliament, has already showed a slight deviation in the recent fiscal policy path, which can be seen, for example, on the plans for the introduction of an extra property tax on large property holdings, which companies in general and real estate investment funds would also have to pay. However, no other major tax changes are expected with regard to Investment taxation.

### Appendix I: Treaty rates for dividends, interest and royalties (%)

	<i>Dividends</i>	<i>Interest</i>	<i>Royalties</i>
Algeria	10/15	15	10
Austria	15	10	5/10
Belgium	15	15	10
Brazil	10/15	15	15
Bulgaria	10/15	10	10
Canada	10/15	10	10
Cape Verde	10	10	10
Chile	10/15	5/10/15	5/10
China	10	10	10
Colombia	10	10	10
Croatia	5/10	10	10
Cuba	5/10	10	5
Cyprus	10	10	10
Czech Republic	10/15	10	10
Denmark	10	10	10
Estonia	10	10	10
Finland	10/15	15	10
France	15	10/12	5

*Portugal*

	<i>Dividends</i>	<i>Interest</i>	<i>Royalties</i>
Georgia	5/10	10	5
Germany	15	10/15	10
Greece	15	15	10
Guinea Bissau	10	10	10
Hong Kong	5/10	10	5
Hungary	10/15	10	10
Iceland	10/15	10	10
India	10/15	10	10
Indonesia	10	10	10
Ireland	15	15	10
Israel	5/10/15	10	10
Italy	15	15	12
Japan	5/10	5	5
Korea	10/15	15	10
Kuwait	5/10	10	10
Latvia	10	10	10
Lithuania	10	10	10
Luxembourg	15	10/12	10
Macao	10	10	10
Malta	10/15	10	10
Mexico	10	10	10
Moldova	5/10	10	8
Morocco	10/15	12	10
Mozambique	15	10	10
Netherlands	10	10	10
Norway	5/15	10	10
Pakistan	10/15	10	10
Panama	10/15	10	10
Peru	10/15	10/15	10/15
Poland	10/15	10	10
Qatar	5/10	10	10
Romania	10/15	10	10
Russia	10/15	10	10
Saudi Arabia	10/15	10	10
Senegal	5/10	10	10
Singapore	10	10	10
Slovakia	10/15	10	10
Slovenia	5/15	10	5
South Africa	10/15	10	10
Spain	10/15	10	5
Sweden	10	10	10

*Portugal*

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	<i>Dividends</i>	<i>Interest</i>	<i>Royalties</i>
Switzerland	5/15	10	5
Tunisia	15	15	10
Turkey	5/15	10/15	10
United Arab Emirates	5/15	10	5
United Kingdom	10/15	10	5
United States	5/10/15	10	10
Ukraine	10/15	10	10
Uruguay	5/10	10	10
Venezuela	10/15	10	10/12

## Appendix 1

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José Pedroso de Melo is a former manager of an international audit firm and two of the largest law firms in Portugal. He has solid experience in the tax area, advising in domestic and international tax law, banking and insurance, restructuring of corporate and high net worth individuals' assets, merger and acquisition operations, compliance procedures and tax litigation. Mr de Melo is recognised as a tax expert by the Portuguese Bar Association, and is recommended as a tax lawyer by the international legal directories *The Legal 500* and *Chambers and Partners*.

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