

PORTUGAL

Vieira de Almeida & Associados



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Having a PE in Portugal: New rules, new challenges ahead

Francisco Cabral Matos and Rita Pereira de Abreu of Vieira de Almeida & Associados consider why the changes to permanent establishment in Portugal raise several challenges.

Portuguese PE standard (2020)

Despite the relevant corporate income tax (CIT) reform undertaken by Portugal in 2014 and the significant changes promoted by the OECD (especially from 2017 onwards) regarding the concept of permanent establishment (PE), the Portuguese CIT Code did not follow such trend towards a more comprehensive definition and preserved a form-over-substance approach. This has been a matter of debate within the Portuguese tax community, given the impact that such changes had in the (re)definition of business models, as well as in the position that tax authorities and tax courts have been taking worldwide in this respect.

Pursuant to the wording of the CIT Code in force up until December 31 2020, in broad terms Portugal adopted the pre-2017 OECD standard, laying down three main concepts of PE:

- A fixed place of business (fixed PE) which generally led to the formal existence of a 'branch';
- The construction project PE – aiming at building sites, construction projects or installation projects; and
- The agency PE. Notably, in respect of the agency PE, the CIT Code still qualified the agent as someone that (in addition to acting on behalf of the non-resident entity) has, and habitually exercises, powers to negotiate and conclude contracts binding on the non-resident company.

Digital economy v. COVID-19: Is there a PE?

OECD's initiative to link the PE risk assessment to a substance-over-form approach was amplified by the challenges raised by the digital economy, specifically addressed in the context of BEPS (especially under pillar one) and leading to discussion on a possible new form of PE based on a 'significant digital presence'.

What the OECD was not expecting was

that the technical difficulties created by a growing dematerialisation of workplaces and the 'normalisation' of remote working would be exponentially increased by a pandemic such as COVID-19. The pandemic implied that even the traditional economy (i.e. activities linked to a significant physical presence) would reinvent itself and find new ways of prospering without depending of a physical nexus with employees, suppliers and/or customers.

In a conservative approach, the OECD published guidance on 'tax treaties and the impact of the COVID-19 pandemic', initially published in April 2020 and updated in January 2021. Such guidance clarifies (and softens) the application of PE provisions, notably as regards the concept of home office, agency PE, construction project PE and even the impact of COVID-19 in the concept of residence for tax treaty purposes. In doing so, the OECD allowed economic players to have more clarity and legal certainty on the (tax) risks that COVID-19 was raising for their businesses, and it has done so almost by considering the pandemic a *force majeure* event that implied softening the application of the typical connecting factors that characterise the current PE concept(s).

Recent changes to the Portuguese PE definition

The pandemic has also led to an innovative view on remote workers and self-employed providers in the digital economy. All around the world, several countries have been promoting new visas and tax programmes for digital nomads (including Portugal – with the non-habitual tax residents' regime – Estonia, Croatia, Greece and Switzerland). The case of Switzerland stands out for the bilateral agreements that took place with neighbouring countries (e.g. Germany, France and Italy) in order to properly address the allocation of taxing rights in the case of remote workers.

Taking into account that Portugal is in the forefront of attracting investment in the digital economy (granting incentives to start-ups, attracting the installation of excellence centres and shared service centres in Portugal and providing for a range of tax benefits to software developers and other entrepreneurs linked with the digital economy (through the non-habitual tax residents' regime), one would expect Portugal to promote a smooth implementation of the new (OECD standard for the) concept of PE.

However, the Portuguese State Budget Law for 2021 included a considerable number of amendments to the PE definition foreseen in the CIT Code, bringing it closer to the international standards (espe-

cially in line with Articles 12, 13, 14 and 15 of the multilateral instrument (MLI)).

It is however surprising, both timewise (why now) and given the current context of economic recovery where legal certainty will be key for economic agents. This is particularly concerning given the absence of public discussion, or even guidance from Portuguese tax authorities on the application and exact impact of said changes. In this 'mix and match' environment, a new unexplored path raises ahead, challenging players with a business presence in Portugal.

As from January 1 2021, the Portuguese PE definition encompasses the following changes:

- The concept of agency PE finally adopts a substance-over-form methodology, in case the agent undertakes a material role for the negotiation and conclusion of any contracts (regardless of being vested with the power to conclude contracts);
- The maintenance of stock in Portuguese territory for delivery of goods (affecting, for example, distant sales) are no longer considered preparatory activities;
- An increased force of attraction principle, which foresees attributes to a Portuguese PE the activities carried out in Portugal by the same non-resident entity or a closely related enterprise, as well as income derived by a nonresident from sales of goods that are identical or similar to those sold by a Portuguese PE;
- Lastly, the PE definition includes, for the first time, a 'service PE' that applies whenever a foreign entity provides services in Portuguese territory for more than 183 days over a 12-month period, either directly or indirectly (e.g. through other service providers).

The updated concept of PE raises several challenges, notably in respect of its interaction with the Portuguese double tax treaty network. It should be noted that although until 2020 there was no domestic concept of service PE, this has been included in more than 20 double tax treaties, including Angola, China, Hong Kong, Denmark, the Netherlands, Luxembourg and Malta. Surely these developments anticipate an increase in tax inspections, tax disputes and therefore it is recommendable that non-resident entities carry out a reassessment of the potential risk of a PE in Portugal.

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