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Corporate Tax

Law and Practice – Portugal

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2018

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Contributed by VdA ***Authors:*** Tiago Marreiros Moreira, Samuel Fernandes de Almeida, Joaquim Pedro Lampreia, Francisco Cabral Matos

Law and Practice

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PORTUGAL LAW AND PRACTICE

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VdA is a Portuguese independent law firm with over 250 staff and 19 practices, which has been involved in many groundbreaking transactions in Portugal and abroad in the last 40 years. VdA has a highly experienced and specialised tax practice team with an in-depth knowledge of both the Portuguese tax environment and of the major international tax systems. VdA has a long-standing reputation in the market for providing quality value-added tax advice to a diverse client base including domestic and multinational economic groups, listed companies and other major corporations, financial institutions, investment funds, family offices and high net worth individuals operating in Portuguese-speaking markets on their domestic and international investments. The team provides both regular/ongoing tax services and tax advice on one-off situations, including: tax optimisation; international tax planning; tax structuring of mergers, spin-offs, privatisations, acquisitions and restructurings; tax planning of financial transactions, capital markets transactions and products; property taxation and estate planning, fees, customs duties, value-added tax and indirect taxes; and tax investigations, disputes and litigation. A high degree of expertise in the field of transfer pricing has also been developed as a result of assistance provided to various major groups of companies operating in the local market.

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1. Types of Business Entity, Residence and Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses usually adopt a corporate form and are taxed for Corporate Income Tax (CIT) purposes separately from their respective shareholders. The alternative corporate forms available are as follows:

- joint stock company ("sociedade anónima");
- limited liability company ("sociedade por quotas");
- collective name company ("sociedade em nome coletivo");
- limited partnership ("sociedade em comandita simples"); and
- limited partnership by shares ("sociedade em comandita por ações").

Joint stock company and limited liability company are the most common forms by far. The key differences between the two are as follows:

- Minimum shareholders: five for the joint stock company; two for the limited liability company (which can be reduced to one shareholder, in which case the name should make mention of the "single shareholder" limited liability company/"sociedade unipessoal por quotas").
- Minimum share capital and respective fulfilment of the contributions:
  - (a) EUR50,000 for the joint stock company; the fulfilment of 70% of the monetary contributions may be deferred for a maximum period of five years, excluding the issue premium if it exists;
  - (b) EUR2 for the limited liability company; the fulfilment of monetary contributions may be deferred for a maximum period of five years and the shareholders may declare, in the constituting document, that the monetary contributions are not to be deposited until the end of the first economic year (this situation is not considered to be a deferment and thus is not subject to commercial registration).
- Corporate structure:
  - (a) for the joint stock company:
    - (i) a Board of Directors (or single director, provided that the share capital does not exceed EUR200,000), an Audit Board or single auditor; or
    - (ii) a Board of Directors (including an Audit Committee) and a Statutory Auditor; or
    - (iii) an Executive Board of Directors (or single Director provided that the share capital does not exceed EUR200,000) and a General and Supervisory Committee as well as a Statutory Auditor;
  - (b) for the limited liability company: one or more managers. The appointment of a supervisory board is not mandatory, although a Statutory Auditor must be appointed when two of the following three limits are exceeded during two consecutive years: total balance sheet of EUR1.5 million; liquid sales and other income of EUR3 million; and an average of 50 employees, per exercise.
- Minority shareholders' rights:
  - (a) for the joint stock company: a two-thirds majority of issued votes is required for certain matters (for example, modification of bylaws, merger and demerger, conversion and dissolution);
  - (b) for the limited liability company, certain matters (for example, modification of bylaws, merger and demerger, conversion and dissolution) require the approval by votes corresponding to three quarters of the share capital;
  - (c) these limits do not apply to the single shareholder limited liability company.
- Shareholders' responsibility:
  - (a) for the joint stock company, the shareholders' responsibility is limited to the respective share capital subscribed (notwithstanding the additional responsibility in a situation where the share capital is wholly owned by another company);
  - (b) for the limited liability company, the shareholders' responsibility is limited to the respective paid-up share capital but the shareholders are also jointly responsible before the company with regard to the subscription of the whole share capital (notwithstanding the additional responsibility in the situation that the share capital is wholly owned by another company).

1.2 Transparent Entities

The following resident entities are subject to a tax transparency regime:

- companies incorporated under the form of civil companies with commercial capacity;
- incorporated firms of professionals;
- asset-management civil companies, the equity capital of which is controlled – directly or indirectly – for more than 183 days by a family group or a limited number of members, under certain conditions;
- Complementary Business Groupings ("ACE"), constituted and operating in accordance with the applicable law; and
- European Economic Interest Groupings ("AEIE") treated as residents.

According to the CIT rules, these entities' taxable profits are directly attributable to the members or shareholders, irrespective of dividend distribution, and taxed according to the applicable rules of Personal Income Tax ("PIT") or CIT, depending on the nature of the shareholder.

Where the shareholders or members of the entities covered by the tax transparency regime are non-resident, the income attributed to them is to be considered as having been acquired through a permanent establishment situated within the Portuguese territory.

1.3 Determining Residence

Similar to the provisions established in the OECD Model Tax Convention on Income and on Capital ("OECD Model"), the CIT Code establishes that an incorporated company should be qualified as resident for tax purposes in Portugal (and, consequently, taxed on its worldwide income) as long as its head office or effective management is located in Portugal.

Taking into account that Portugal disregards certain entities for tax purposes (please refer to the comments above) and treats them as tax-transparent (taxing instead the respective members or shareholders in accordance with their own share of the income of the transparent entity), the transparent entities are not liable to pay CIT (although they are subject to almost all other CIT rules). In such a case, since the income of the transparent entity is "transferred" to its members or shareholders under domestic law, the latter are liable to tax on that income and are thus the appropriate persons to claim the benefits of the double tax treaties ("DTT") concluded between Portugal and other States of which they are residents.

1.4 Tax Rates

The CIT rate is applied at a graduated rate, as follows:

- a 17% tax rate applies to income of up to EUR15,000 generated by small or medium enterprises ("SME"); and
- a 21% tax rate applies to income higher than EUR15,000 obtained by SME and to the totality of the income obtained by other companies (non-SME).

These rates are lower if the corporate entity has its head office and place of effective management in the Azores Islands, or if the corporate entity is licensed to operate in the International Business Centre of Madeira Island.

A municipal surcharge ("derrama municipal") is added to the CIT in most municipalities, at a rate of up to 1.5% of the taxable income.

Corporate taxpayers with a taxable income of more than EUR15 million are also subject to a State surcharge ("derrama estadual") on the part of taxable profits that exceed this threshold, as follows:

- taxable profits between EUR1.5 million and EUR7.5 million are subject to a rate of 3%;
- taxable profits between EUR7.5 million and EUR35 million are subject to a rate of 5%;
- taxable profits in excess of EUR35 million are subject to a rate of 7%.

If the business is owned by individuals (directly or through tax-transparent entities), the related net income amount will be aggregated with the other types of income earned by individuals, and will be subject to the general progressive rates established in the PIT Code.

These general progressive rates start at a minimum of 14.5% on taxable income above EUR7,091, raising to 48% for income above EUR80,640. These rates are currently increased by a general "extraordinary surtax", which will be due for the 2017 tax year as follows:

- 0% for taxable income up to EUR20,261;
- 0.88% for taxable income between EUR20,261 and EUR40,522;
- 2.75% for taxable income between EUR40,522 and EUR80,640; and
- 3.21% for taxable income exceeding EUR80,640.

If the taxable income exceeds EUR80,000, another "solidarity surtax" applies, at a rate of 2.5% for between EUR80,000 and EUR250,000, and 5% for taxable income exceeding EUR250,000.

Whether conducted through a company or by an individual, a business may also be subject to autonomous taxation on certain charges and expenses incurred in the execution of a professional or business activity, such as expenses incurred with passenger light or mixed vehicles, motorbikes and motorcycles (with the exception of vehicles solely powered by electric energy), certain travelling expenses, amounts paid or payable to non-resident blacklisted entities, non-documented expenses, and certain indemnities and bonuses (or other variable compensations) paid to managers and directors. In general, the rates applicable to this autonomous taxation range from 5% (applicable, namely, to daily allowances and expenses concerning the use of the employee's own vehicle for the benefit of the employer, not invoiced to clients and not subject to PIT) up to 70% (regarding the non-documented expenses incurred by certain taxable persons), with the possibility of such rates being increased by 10% whenever the taxable person presents tax losses in the respective fiscal year.

2. Key Features of the Tax Regime

2.1 Calculation of Taxable Profits

With regard to resident corporate entities performing mainly commercial, industrial or agricultural activities, taxable income is based on the accounting profits, representing the algebraic sum of the net income for that period (the difference between profits or gains and costs or losses), as well as some positive or negative variations in net equity during the same period, which are not reflected in the accounting net profit or loss. The accounting profit or loss will also be adjusted in accordance with specific tax corrections provided for in the CIT Code. These tax corrections refer, mainly, to non-deductible accounting costs (eg, CIT, non-documented and illicit expenses, certain fines and penalties of a non-contractual nature, indemnities for any events for which the risk is insurable, taxes or any other charges levied on third persons which the enterprise is not entitled to bear, certain capital losses related to equity instruments, certain daily allowances for expenses and compensation in respect of the use by the employee of their own vehicle in the service of their employer which are not attributable to clients and not subject to PIT, interest and any other kind of remuneration of supplies and loans granted to the company by its shareholder for that part in excess of an amount corresponding to Euribor 12-month reference rate on the day in which the debt was incurred plus a 6% spread – for SME – or plus a 2% spread for the remaining companies) or non-taxable accounting profits (eg, unrealised capital gains recognised in the accounts, or income derived from a sale and leaseback operation).

Another important factor is the overall limitation of deduction of net interest expenses (paid on related and unrelated party debt) exceeding either EUR1 million or 30% of EBITDA, whichever is greater, adjusted by excluding certain items such as income resulting from shares eligible for the participation exemption or attributable to a permanent establishment outside Portugal to which the option for exemption is applied, as explained below.

For non-resident entities with a permanent establishment in Portugal, the taxable base is the profit attributable to that permanent establishment as per the above rules. For non-resident entities without a permanent establishment (or if the income is not attributable to it), the taxable base is made up of income in the different categories separately considered for PIT purposes, subject to withholding taxes in most cases.

2.2 Special Incentives for Technology Investments

The CIT Code establishes a 50% exemption on the gross income derived from the assignment or temporary use of patents and industrial models or designs, as well as to any indemnities resulting from the infringement of those IP rights, as long as certain conditions are met. To prevent any abuse of planning regulations, it is stipulated that income derived from an assignee resident in a blacklisted territory will not benefit from this tax relief.

A tax credit for qualifying R&D expenses (designated as "Sistema de incentivos fiscais em investigação e desenvolvimento empresarial II" – System of tax incentives for corporate R&D or "SIFIDE II") is available from 1 January 2014 until 31 December 2020.

The creditable amount is the sum of:

- a tax credit, corresponding to 32.5% of the qualifying expenses incurred in a given year of that timespan; and
- an additional credit, equal to 50% of the expenses incurred during that period of time in relation to the single arithmetic average of the previous two exercises, up to a limit of EUR1.5 million.

Under this system, expenses not deducted in a given accounting period for the lack or insufficiency of a basis for tax assessment may be deducted in the subsequent eight accounting periods.

In order to make use of that credit, the qualifying investor must comply with certain substantive conditions (eg, its taxable profit must not be determined through indirect methods) and formal conditions (a compliance statement, issued by a verification body to be appointed by the Minister of Economy, concerning the qualifying R&D expenditure effectively incurred and a statement evidencing the amount of the tax benefit should be included in the tax documentation files).

This R&D tax credit may not be used at the same time as any other similar tax incentive.

There is also a possibility (within certain conditions) that the CIT will provide for costs related to the acquisition of IP rights such as trademarks, licences, production processes and models, and for other similar rights acquired for consideration which do not have a determined life cycle basis of intangible assets and for which a determined life cycle has not been deducted, pursuant to the straight-line method, during the first 20 tax years (ie, 5% per year) from the initial record of the asset in the company's books.

2.3 Other Special Incentives

In a recent Investment Tax Code prepared in accordance with the EU Regulations and respecting the maximum ceilings established under the State Aids EU legislation applicable to regional investments, Portugal has compiled a set of tax benefits focused on the development of productive-investment projects within the following economic activities:

- the manufacturing and mining industry;
- tourism and tourism-related activities as provided for in applicable law;
- computers and related services and activities;
- agriculture, fisheries, forestry and livestock activities;
- R&D of hi-tech activities;
- information technology and audiovisual and multimedia production;
- defence, environment, energy and telecommunications; and
- shared service centres' activities.

These tax benefits may be aggregated in two different regimes, as follows:

- The contractual tax benefits for productive-investment projects regime (applied solely to investments for which the qualifying expenses to be incurred are equal to or higher than EUR3 million), which grants the following tax incentives, until 31 December 2020 and for up to ten years:
  - (a) a tax credit, determined by applying between 10% and 25% of the project's qualifying expenses, to be deducted from the CIT tax assessment (this CIT deduction is subject to certain limits and is made in the CIT assessments calculated during the fiscal year in which the relevant investment was made or, when it cannot be fully deducted, the amount not yet deducted may be subject to the same conditions

when paying during fiscal years until the end of the tax-benefits contract);
(b) exemption or reduction of the Municipal Real Estate Tax ("IMI"), for buildings used by the promoter in the course of the investment project;
(c) exemption or reduction of the Municipal Real Estate Transfer Tax ("IMT"), with respect to property acquired by the promoter in the course of the investment project and during the investment period; and
(d) exemption or reduction of any Stamp Duty ("Imposto do Selo") owed, for all acts or contracts required to complete the investment project.

- The investment support tax regime, which grants the following tax incentives:
  (a) for investments made in regions eligible for support under paragraph 3a) of Article 107 of the Treaty on the Functioning of the European Union ("TFEU"), a CIT deduction (to be made, under certain limits, in the CIT assessments calculated during the fiscal year in which the relevant investment was made or, when it cannot be fully deducted, the amount not yet deducted may be under the same conditions when paying during the following ten fiscal years), as follows:
    (iv) 25% of the relevant investment, for an investment of up to EUR10 million; and
    (v) 10% of the relevant investment, for the part of the investment that exceeds EUR10 million;
  (b) for investments made in regions eligible for support under paragraph 3c) of Article 107 of the TFEU, a CIT deduction (to be made, under certain limits, in the CIT assessments calculated during the fiscal year in which the relevant investment was made or, when it cannot be fully deducted, the amount not yet deducted may be subject to the same conditions when paying during the following ten fiscal years) of 10% of the qualifying expenses;
  (c) exemption or reduction of the IMI for a period of up to ten years for buildings qualified as relevant for this purpose and used by the promoter in the course of the investment project;
  (d) exemption or reduction of the IMT, with respect to buildings qualified as relevant and acquired by the promoter in the course of the investment project; and
  (e) exemption from Stamp Duty on the purchase of buildings related to the relevant investment.

These tax regimes are subject to compliance with a certain number of eligibility requirements and may not be cumulated at the same time as other similar tax incentives.

2.4 Basic Rules on Loss Relief

Tax losses may be carried forward for up to 5 years (SMEs that perform mainly commercial, industrial or agricultural activities may carry forward losses for up to 12 years), but in each fiscal year the related deduction cannot currently exceed 70% of the respective taxable profit. No carry-back is available.

The carry-forward may be lost, however, if the event of a change of ownership of 50% of the target company's stock or the majority of the voting rights (under a stock deal), with the following exceptions:

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

In order to avoid the loss of the carry-forward, the taxpayer must obtain authorisation from the Minister of Finance, which is granted only if valid economic reasons are demonstrated.

2.5 Limits on Deduction of Interest

The net financial costs borne by a resident company or by a permanent establishment of a foreign company (with the exception of entities subject to the supervision of the Bank of Portugal or the Portuguese Insurance Institute, and of Portuguese branches of credit, financial or insurance companies and credit securitisation companies) may be deductible up to either EUR1 million or 30% of the 'tax EBITDA' (profit before depreciations, net financial costs and taxes, as amended in accordance with the tax provisions), whichever is higher.

As a result of these limits, the net financial costs which are not deductible in a certain given fiscal year may be carried forward for a period of five fiscal years, as long as those limits are complied with. When the amount of financial costs considered as tax deductible is lower than the percentage limit, the unused part of that limit may be carried forward for a period of five fiscal years (increasing the maximum deductible amount), until that remaining part is fully used.

Also, transfer pricing rules need to be complied with.

2.6 Basic Rules on Consolidated Tax Grouping

Tax grouping is allowed, provided that the parent company holds – directly or indirectly – at least 75% of the capital and more than 50% of the voting rights of the subsidiaries (the capital may be held either through Portuguese entities who meet the conditions for inclusion in the group and/or through entities resident in another EU Member State or the European Economic Area ("EEA"), provided that these non-resident companies are held, directly or indirectly, with a percentage of at least 75% by the dominant company).

Other formal and minor substantive conditions should also be met by the parent company and/or the subsidiaries in order to apply the tax grouping regime.

Tax grouping allows the group companies to offset the tax losses incurred by one company against the profits of other companies. Similar to what is currently expected in the general tax carry-forward regime, the tax losses assessed within the tax grouping may be carried forward but may only be deducted in each fiscal year by up to 70% of the group taxable profit.

2.7 Capital Gains Taxation

Under the current participation exemption regime, capital gains (but also capital losses) obtained by local companies (holdings and operational companies) on the sale of other corporations may be excluded from CIT, provided that the following conditions are met at the date of the transaction:

- the selling company holds at least 10% of the share capital or voting rights in the entity from which the shares are transferred;
- the participation has been held continuously for 12 months prior to the sale;
- the selling company is not subject to a tax transparency regime;
- the entity from which the shares are transferred is not exempt from:
  - (a) CIT;
  - (b) any of the corporate income taxes referred to in the Parent Subsidiary Directive; or
  - (c) a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT rate – this condition may be waived under certain circumstances;
- the entity from which the shares are transferred is not resident in a blacklisted jurisdiction; and
- the assets of the entity from which shares are transferred are not comprised – directly or indirectly – of more than 50% of real estate located in Portugal and acquired on or after 1 January 2014 (except if that real estate is allocated to an agricultural, industrial or commercial activity that does not consist of buying and selling real estate).

This rule is also applicable to capital gains on the transfer of shares derived from a non-tax neutral merger, division, transfer of assets, or exchange of shares, and also in the case of a transfer of supplementary capital.

Thes regime also applies to capital gains (and capital losses) obtained by a Portuguese permanent establishment of:

- a company resident in an EU Member State that complies with the requirements provided for in the EU Parent-Subsidiary Directive;
- a company resident in a Member State of the EEA that is subject to tax co-operation obligations similar to the ones established within the EU, provided that the entity complies with requirements that are comparable to those provided for in the EU Parent-Subsidiary Directive; or
- a company that is resident in a State with which Portugal has concluded a DTT that provides for the exchange of information and is not exempt in its State of residence from an income tax similar to the Portuguese CIT (not applicable to companies resident in a blacklisted territory).

If the participation exemption regime described above is not applied, the positive net difference between capital gains and capital losses arising from the transfer of shares will be taxed as part of the normal income for CIT purposes.

2.8 Other Taxes on Transactions

In an asset deal, if the operation qualifies as a transfer of a going concern, stamp duty may be due at a rate of 5% of the value of the deal. Stamp tax will not be triggered if the operation cannot be regarded as a contribution of a totality of assets, or part thereof, where the acquirer is to be treated as the successor to the transferor, but each individual item will be subject to VAT at the applicable rates (currently varying between 6% and 23%).

Whenever real estate property is transferred, IMT and stamp duty are due to be paid on the real estate's tax value, or the value at which the assets were transferred to the acquiring company (whichever is higher), at the following rates:

- IMT:
  - (a) 5% for rural real estate property;
  - (b) 6.5% for urban real estate property; and
  - (c) 10% whenever the acquirer is resident for tax purposes in a blacklisted jurisdiction.
- Stamp duty: 0.8%.

In a stock deal, the direct acquisition of at least 75% of the corporate rights or shares in a collective name company ("sociedades em nome coletivo"), in a limited partnership ("sociedades em comandita simples") or in a limited liability company ("sociedade por quotas") that owns real estate property may also trigger IMT at the rates mentioned above. The acquisition of stock does not trigger any other transaction taxes.

Depending on the transaction, notarial charges may also be levied.

In general terms, an incorporated business may have to deal with VAT (regarding, namely, the supply of goods and services located in Portugal which are not subject to any particular exemption), custom duties (in accordance with the types and origin of the imported goods), excise duties (there are different excise duties applicable, namely to oil and energy products, alcohol and alcoholic beverages, tobacco and vehicles), the IMI, IMT and Stamp Duty (which is applicable to a wide range of acts, transactions and documents), and also Social Security contributions (due from the employers – and also the employees – within a labour relationship, on a monthly basis).

Certain sectors of the economy, such as financial, energy, telecoms and pharmaceutical, also face certain special contributions recently created or provided for by the Portuguese Government in order to address current budgetary needs.

3. Division of Tax Base Between Corporations and Non-Corporate Business

3.1 Closely Held Local Businesses

In general terms, the corporate form is more commonly used in order to carry on a particular business, for the following reasons, amongst others:

- the simplicity of the incorporation of a company;
- the possibility of implementing a debt pushdown strategy (within a transaction scenario);
- the possibility of setting up a tax group (within a group of companies);
- the possibility of implementing a ring-fencing strategy (in order to segregate risks and personal or corporate wealth between different businesses and activities); and
- the possibility to create a specific and separate profit and costs centre.

3.2 Corporate Rates and Individual Rates

As referred to above, incorporated firms of professionals are mandatorily subject to the tax transparency regime and therefore the taxable profits of these entities are directly attributable to their shareholders (the professionals), irrespective of dividend distribution, so the rules of PIT and the respective tax rates will apply.

However, if an individual professional intends to carry on a certain activity on their own, they may (without any particular restriction) set up a limited liability company with only a single shareholder (“sociedade unipessoal por quotas”), in which case the income generated from that activity will be subject to the rules and (lower) rates provided for in the CIT Code (instead of the rules and rates stated in the PIT Code). In this scenario, the individual professional will be taxed solely on the profits that his or her company may distribute, at an autonomous rate of 28% (with the option to aggregate the distributed profits).

3.3 Accumulation Earnings for Investment Purposes

There are no rules in Portugal to prevent closely held corporations from accumulating earnings for investment purposes. In fact, in Portugal there is a tax incentive (the “Dedução por Lucros Retidos e Reinvestidos” or “DLRR”) for micro and SME, which grants a CIT deduction of 10% of the retained and reinvested earnings (up to a maximum of EUR5 million per year) used in the acquisition of qualifying assets. This reinvestment should be made within two years, calculated from the end of the fiscal year in which the earnings are obtained. The annual deduction is capped at 25% of the CIT due.

3.4 Sales of Shares in Closely Held Corporations

As a general rule, dividends distributed by resident entities to resident or non-resident individuals are subject to a final withholding tax, at a rate of 28%. Dividends paid by non-resident entities to resident individuals are also subject to a flat rate of 28% (as a general rule, a tax credit to avoid or waive international double taxation is available).

In cases where such payments are made to master accounts (opened in the name of one or more account holders acting on behalf of one or more unidentified third parties), a withholding tax at a rate of 35% may be applicable, unless the beneficiary is disclosed, at which point the general rate will apply. This aggravated withholding tax rate of 35% will also be applicable to investment income payments made to resident individuals by non-resident entities domiciled in a blacklisted jurisdiction (through a resident paying agent).

If the resident shareholder opts to include the dividends on their taxable amount, only 50% of that amount will be subject to a personal income progressive tax rate of up to 48% (increased by the extraordinary surtax and eventually by the solidarity surtax). In this case, the withholding tax rate of 28% will be on account of the final tax bill. Dividends are subject to taxation at the time they are made available to the taxpayer.

For dividends paid to non-resident individuals, the domestic withholding tax referred to above can be reduced to between 5% and 15% under the applicable DTT concluded between Portugal and the respective State of residence, but the applicable rules should be confirmed on a case-by-case basis. To apply for the reduced withholding tax rates provided for in the DTT, some formalities must be complied with no later than the tax due date (eg, the presentation of tax forms – Model 21-RFI – duly certified by the recipient’s tax authorities and/or a certificate of residence issued by the recipient’s tax authorities) in order to confirm that the requirements have been met.

Regarding capital gains, the annual positive difference between capital gains and losses concerning the disposal of shares is subject to a special tax rate of 28%, unless the taxable person opts to include the gains on their taxable income, subject to a personal income progressive tax rate of up to 48% (increased by the extraordinary surtax and eventually by the solidarity surtax). For micro and small companies' shares, only 50% of the positive difference between capital gains and losses arising on their sale will be subject to taxation.

According to a specific tax benefit, capital gains from the sale of shares in a local company that are obtained by a non-resident individual will be exempt from taxation in Portugal, unless:

- the non-resident individual is domiciled in a blacklisted jurisdiction; or
- the capital gains obtained by the non-resident refer to the direct or indirect disposal of shares in a resident company, more than 50% of whose assets are comprised of real estate property located in Portugal.

3.5 Sales of Shares in Publicly Traded Corporations

Please refer to the comments above, as the tax treatment applicable to dividends and or capital gains derived from public or private companies is similar to that applicable to other companies.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Under Portuguese domestic tax rules, interest, dividends and royalties paid by Portuguese resident companies to non-resident entities are subject to withholding tax at a rate of 25%. The tax must be withheld at the time of the payment or availability of the dividends to the shareholders, the maturity date of the interest or the date of the assessment of the royalties, whichever is earlier.

With respect to dividend payments, the withholding tax can be eliminated by the application of the participation exemption regime, which has a wider scope than mere compliance with the EU Parent-Subsidiary Directive provisions. Therefore, outbound dividends are exempt from withholding tax at CIT level provided that the following conditions are met:

- The beneficiary of the income is resident in:
  - (a) another EU country;
  - (b) an EEA country bound to administrative co-operation similar to that applicable between EU countries; or
  - (c) a country with which Portugal has concluded a DTT providing administrative co-operation similar to that applicable between EU countries.
- The beneficiary of the income:
  - (a) holds at least 10% of the share capital or voting rights of the distributing company;
  - (b) holds the participation continuously for 12 months prior to the distribution of the dividends; and
  - (c) is not exempt from any of the CITs referred to in the EU Parent Subsidiary Directive, or a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT rate.

This exemption is also applicable to dividends paid to permanent establishments located in another EU or EEA country from an entity compliant with the requirements referred to above.

To apply for the withholding tax exemption, the beneficiary of the income must present a declaration, duly signed and certified by the recipient's tax authorities, prior to the disposal of the dividends in order to evidence its tax residence and the applicable CIT regime.

The withholding tax exemptions are not applicable if there is an arrangement or a series of arrangements which are not genuine, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of eliminating the double taxation of dividends, having regard to all relevant facts and circumstances.

Concerning interest and royalty payments, the withholding tax can be eliminated by the application of the EU Interest and Royalties Directive, under which no withholding tax is due over interest and royalty payments made by Portuguese companies, provided the following conditions are met:

- the paying and beneficiary entities should be subject to (and not exempt from) corporate tax and take one of the legal forms listed in the annex of this Directive;
- both entities have to be considered as EU residents for DTT purposes;
- a direct 25% shareholding must be held by one of the companies in the other's capital, or both must be sister companies (ie both held, in at least 25%, by the same direct shareholder), and in either case the shareholding must be held for at least a two-year period; and
- the entity receiving the interest payment should be its effective beneficiary.

Interest and royalty payments made to a company or a permanent establishment resident in Switzerland may also benefit from the withholding tax exemption, as long as the conditions (with the proper adjustments) referred to above are also met.

Investment income (which includes interest, dividends and royalties, amongst other forms of income) paid or made available to master accounts (opened in the name of one or more account holders acting on behalf of one or more unidentified third parties) is subject to a final withholding tax of 35% (unless the beneficiary is disclosed, in which case the aforementioned general rate will apply).

This withholding tax rate will also be applied to the investment income payments made to entities resident in a blacklisted jurisdiction.

To apply for the reduced or zero withholding tax rates provided for in the EU Interest and Royalties Directive, some formalities must be complied with no later than the tax due date (eg, the presentation of tax forms – Model 01-DJR – duly certified by the recipient's tax authorities and/or a certificate of residence issued by the recipient's tax authorities) in order to confirm that the requirements to apply such a tax saving are met.

The waiver of the withholding tax on interest and royalty payments under the EU Interest and Royalties Directive may not be applicable to the part of the income that is not compliant with the arm's-length principle.

4.2 Primary Tax Treaty Countries
According to public data, the primary tax treaty countries which are used by investors to perform foreign direct investments in Portugal are the Netherlands, Spain, Luxembourg, the United Kingdom, France, Brazil, Belgium, Germany, Ireland, Switzerland, the United States and Italy.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents
Despite the increased focus of the Portuguese tax authorities on dealing with cross-jurisdictional tax issues in order to counter treaty shopping practices, there are no relevant developments concerning the ability of the Portuguese tax administration to work with other tax administrations on such matters.

In any case, in the last publicly available report on activities developed towards the combat of fraud and tax evasion, published by Portugal's Tax Affairs Office, it was revealed that one of the focuses on which tax audits are centring their attention is the enhancement of measures to combat international tax evasion through the control of transfer pricing policies, the payments made to other group companies based in countries with a more favourable tax regime, and transactions made with tax havens and with interposed companies.

Another measure identified in the report is the intention of tax authorities to identify the perimeter of economic groups and promote control activities to cover all operations involving group companies. In order to deal with this enhanced focus on transfer pricing matters, the tax authorities have already hired a large number of specialists to be included in the teams responsible for transfer pricing audits and Advance Pricing Agreement ("APA") negotiations.

4.4 Transfer Pricing Issues
The major transfer pricing issues that typically have to be dealt by foreign investors regarding local corporations relate to the terms and conditions agreed between both parties concerning interest, royalties and management services payments.

4.5 Related Party Limited Risks Distribution Arrangements
Portugal mainly follows the OECD standards regarding transfer pricing matters. However, Portuguese law provides for a much lower participation threshold (currently 20%) for two entities to be considered as related for transfer pricing rules.

4.6 Variation from OECD Standards
In general terms, a domestic branch's profits are taxed on the same basis as corporate profits.

Nevertheless, the following differences in the tax regime applicable to a domestic branch of a foreign entity should be considered:

- income remitted by a branch to its head office is exempt from tax withheld at source;
- general administrative expenses incurred by the head office may, as a general rule, be allocated to the branch (following certain criteria); and
- there may be certain restrictions concerning the deductibility of certain expenses charged by the head office to the branch (eg, interests and royalties).

5. Key Features of Taxation of Non-Local Corporations

5.1 Taxation of Non-Local Corporation Versus Local Subsidiaries
In general terms, a domestic branch's profits are taxed on the same basis as corporate profits.

Nevertheless, the following differences in the tax regime applicable to a domestic branch of a foreign entity should be considered:

- income remitted by a branch to its head office is exempt from tax withheld at source;
- general administrative expenses incurred by the head office may, as a general rule, be allocated to the branch (following certain criteria); and
- there may be certain restrictions concerning the deductibility of certain expenses charged by the head office to the branch (eg, interests and royalties).

5.2 Capital Gains of Non-Residents

According to the Portuguese Tax Benefits Code, the capital gains obtained by non-residents on the disposal of stock in a Portuguese company are exempt from taxation in Portugal unless:

- more than 25% of the non-resident company is owned – directly or indirectly – by Portuguese tax residents, except if the following requirements are cumulatively met:
  - (a) the n is resident in an EU Member State, in an EEA Member State which is bound to co-operate with Portugal on tax matters under an administrative co-operation arrangement similar to the exchange of information schemes within the EU Member States, or in a country with which Portugal has a double tax treaty in force that foresees the exchange of information;
  - (b) the beneficial owner is subject to and not exempt from a tax referred to in article 2 of Council Directive 2011/96/UE of 30 November 2011, nor from a tax of similar nature with a rate not lower than 60% of the Portuguese IRC rate (currently 12.6%);
  - (c) the beneficial owner holds – directly or indirectly – at least 10% of the share capital or voting rights of the entity disposed for at least 1 year uninterruptedly; and
  - (d) the beneficial owner is not part of an arrangement or series of arrangements which have been put in place for the main purpose of obtaining a tax advantage;
- the non-resident company is domiciled in a blacklisted jurisdiction as defined by the ministerial ordinance 150/2004, of 13 February, as amended; or
- the capital gains obtained by the non-resident refer to the direct or indirect disposal of shares in a resident company, more than 50% of whose assets are comprised of real estate property located in Portugal.

Certain DTTs (but not all) signed between Portugal also provide for the waiver of taxation regarding capital gains obtained from the sale of a local company.

No Portuguese taxation applies on capital gains derived from the sale of a non-local holding company (even if the latter owns stock in a local company), unless the beneficiary of the income is a resident company or individual (in which case the general taxation rules may apply).

5.3 Change of Control Provisions

Please refer to comments above regarding this matter.

5.4 Determining the Income of Foreign-Owned Local Affiliates

Both local-owned companies and foreign-owned local affiliates are subject to the same rules regarding the assessment of respective taxable income.

5.5 Deductions for Payments by Local Affiliates

As a general rule, payments related to management and administrative expenses made by local affiliates to non-local affiliates are deductible, provided that they are considered necessary for the activities of the local affiliate. In any case, the terms and conditions related to the provision of such services and the payment of the respective consideration should be in accordance with the arm's-length principles.

5.6 Contraints on Related Party Borrowing

There are no specific constraints, besides the one mentioned above regarding the deductibility of the interest borne by resident companies.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

Portugal imposes tax on the worldwide income of business entities with a head office or effective management in Portugal. All income is included in the tax base, regardless of the geographical location it was derived from, and all allowable items of expense, deduction and credit are taken into account. A credit deduction for international double taxation is allowed when income derived from abroad is included in the taxable income.

The tax credit will correspond to the lowest of the following amounts:

- the income tax paid abroad, or
- the CIT fraction assessed before the deduction, corresponding to the net income that may be taxed in the respective country.

Whenever a DTT is applicable, the tax credit may not exceed the tax that should have been paid abroad according to the terms laid out under the DTT.

In order to ensure that there is no distortion between foreign subsidiaries and foreign permanent establishments, an (optional) tax exemption applicable to profits that can be attributable to a foreign permanent establishment has been in force since 2014. This optional regime is subject to compliance with the following conditions:

- the permanent establishment is subject to and not exempt from any of the corporate income taxes referred to in the Parent Subsidiary Directive, nor from a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT rate; and
- the permanent establishment is not a resident in a blacklisted jurisdiction.

The option to apply this rule must encompass at least all the permanent establishments located in the same territory, and should remain in force for at least three years.

Please note that the Portuguese head office may not elect to exclude the profits assessed by the foreign permanent establishment from its taxable income, up to the amount of tax losses assessed by the same permanent establishment that were relevant to determine the Portuguese company's taxable income in the previous 5 fiscal years (except for SME, where a 12-year period applies).

Also, the Portuguese head office may not elect to include the losses assessed by the foreign permanent establishment in its taxable income, up to the amount of profits the same permanent establishment has assessed that were not relevant to determine the Portuguese company's taxable income in the previous 5 fiscal years (except for SME, where a 12-year period applies).

6.2 Non-Deductible Local Expenses
Please refer to **6.1 Foreign Income of Local Corporations**.

6.3 Taxation on Dividends from Foreign Subsidiaries
Dividends received by a corporate shareholder are to be included in the taxable profit assessment and subject to CIT, at the rates explained above.

In any case, under the participation exemption regime that was mentioned above, inbound dividends obtained by companies resident in Portugal may be excluded from CIT, provided that the following conditions are met:

- the Portuguese shareholding company holds at least 10% of the share capital or voting rights of the distributing entity;
- the participation has been held continuously for the 12 months prior to the distribution of the dividends (or, if held for a lesser period, is kept until the period of 12 months is completed);
- the Portuguese shareholding company is not subject to a tax transparency regime;
- the distributing entity is subject to and not exempt from CIT, any of the corporate income taxes referred to in the Parent Subsidiary Directive, or a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT rate; and
- the distributing entity is not a resident in a blacklisted jurisdiction.

The condition for the distributing entity to be subject to a tax with a rate not lower than 60% of the Portuguese CIT rate may be disregarded if at least 75% of the subsidiary profits derive fromagricultural or industrial activities in the residence jurisdiction, or from commercial or services activity not directed predominantly to the Portuguese market, and if the main activity is not related to (i) banking, (ii) insurance, (iii) shareholdings of less than 5% of the capital or in blacklisted entities, or other securities, intellectual or industrial property rights, and know-how, or (iv) rental activity, except real estate in the residence jurisdiction, and he subsidiary is not fully exempt from corporate income tax.

The withholding tax exemption referred to above is not applicable if there is an arrangement or a series of arrangements which are not genuine, having been put in place for the main purpose of obtaining a tax advantage that defeats the object or purpose of eliminating the double taxation of dividends, having regard to all relevant facts and circumstances.

6.4 Use of Tangibles
Any transfer, assignment or use of intangibles developed by local corporations for the benefit of non-local subsidiaries should be made in accordance with the arm's-length principle. Therefore, it is important to verify whether or not independent parties would also be willing to transfer that asset without a particular consideration. If any income is obtained by the local company from such a transfer, assignment or use, it will be subject to taxation as a part of the respective taxable profit, in which case the patent box regime (as described above) may eventually apply.

6.5 Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules
The Portuguese CFC rules are similar to the ones that have been adopted by other EU countries, meaning that there will be an assessment of the shareholding threshold in a non-resident entity, the verification of the location of the latter in a tax-privileged territory, the evaluation of profit generated by the respective economic activity and, finally, the taxation of the respective income, regardless of any dividend distribution.

In order to apply the Portuguese CFC rules, the resident shareholders (either individuals or corporations) of the non-resident entity located in the tax-privileged territory must hold (directly, indirectly or even through a fiduciary structure or an interposing agent) at least 25% of the shares, voting rights, profit rights or assets of that non-resident entity (reduced to 10% if the non-resident company is held more than 50% by resident shareholders).

For this purpose, a controlled foreign entity is an entity domiciled in a tax-privileged territory that is exempt from or not subject to an income tax similar to CIT, or when the applicable tax rate is lower than 60% of the Portuguese CIT rate.

However, CFC rules will not apply if at least 75% of the subsidiary profits derive from agricultural or industrial activities in the residence jurisdiction, or from commercial or services activity not directed predominantly at the Portuguese market, and the main activity is not related to (i) banking, (ii) insurance, (iii) shareholdings of less than 5% of the capital or in blacklisted entities, or other securities, intellectual or industrial property rights, and know-how, or (iv) rental activity, except real estate in the residence jurisdiction.

6.6 Rules Related to the Substances of Non-Local Affiliates

There are no specific rules related to the substance of non-local affiliates (apart from the ones mentioned in the previous paragraph). In any case, the CIT Code provides that a company may be qualified as a tax resident whenever its effective management takes place in Portugal. Therefore, if a non-local affiliate does not respect certain levels of substance requirements (eg, the presence of local directors, the existence of local board meetings, etc), there is a risk that such a non-resident company may become a resident for Portuguese CIT purposes.

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

Under the current participation exemption regime, capital gains obtained by local companies on the sale of non-local affiliates may be excluded from CIT, provided that the following conditions are met:

- the Portuguese shareholding company holds at least 10% of the share capital or voting rights of the distributing entity;
- the participation has been held continuously for the 12 months prior to the sale;
- the Portuguese shareholding company is not subject to a tax transparency regime;
- the foreign affiliate is subject to and not exempt from CIT, any of the corporate income taxes referred to in the Parent Subsidiary Directive or a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT; and
- the foreign affiliate is not a resident in a blacklisted jurisdiction.

The condition for the distributing entity to be subject to a tax with a rate not lower than 60% of the Portuguese CIT rate may be disregarded:

- if at least 75% of the subsidiary profits derive from agricultural or industrial activities in the residence jurisdiction, or commercial or services activity not directed predominantly at the Portuguese market, and
- if the main activity is not related to (i) banking, (ii) insurance, (iii) shareholdings of less than 5% of the capital or in black-listed entities, or other securities, intellectual or industrial property rights, and know-how, or (iv) rental activity, except real estate in the residence jurisdiction.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

The general anti-avoidance rule determines that acts or legal transactions are ineffective for tax purposes if they are essentially or mainly directed at the reduction, elimination or deferral of the taxes that would be due as a result of facts, acts or legal transactions with an identical economical purpose, or at obtaining a tax advantage that would not be achieved, totally or partially, without the use of those artificial or fraudulent means, through artificial or fraudulent means and with abuse of juridical forms.

The Portuguese tax authorities will consider such artificial or fraudulent means ineffective and, as a result, the income that derives from them will be taxed in accordance with the rules applicable in their absence.

It is also possible to identify several other specific anti-abusive provisions, such as the aforementioned limitation in the deductibility of interest (which has replaced the previous thin capitalisation rules), the CFC rules, the transfer pricing rules and a series of anti-abusive rules dealing with payments to blacklisted jurisdictions.

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VIEIRA DE ALMEIDA

8. Other

8.1 Regular Routine Audit Cycle

Following a trend adopted by the majority of OECD member countries, Portugal has also created a Large Taxpayers Unit, which is responsible for dealing exclusively with monitoring, assisting and auditing major taxpaying companies and groups.

The Portuguese tax authorities annually approve a National Plan of Activities of the Tax Inspection ("Plano Nacional de Atividades da Inspeção Tributária" or "PNAIT"), which defines the programmes, criteria and actions that are the basis for the selection of taxable persons to be inspected, and sets targets to be achieved by central, regional and local organisational units.