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Portugal

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Highlights

Portuguese tax highlights

1) Amendments to the tax incentives statute

With effect as of July 2018, Portugal enacted a mid-year amendment to the Tax Incentives Statute, which included, *inter alia*, changes to the following exemptions applicable to non-resident financial institutions deriving income from Portuguese sources:

- Interest payments paid by Portuguese-resident financial institutions, which are not attributable to a Portuguese-situs Permanent Establishment ("PE");
- Gains from swaps entered with Portuguese credit institutions, which are not attributable to a Portuguese-situs PE;
- Gains and interest from swaps and forward contracts entered into with the Portuguese State acting through the Portuguese Treasury and Social Security agencies, provided that this income is not attributable to a Portuguese-situs PE;
- Interest from savings accounts held by non-resident credit institutions in Portuguese banks.

These exemptions will no longer apply (i) when the beneficiaries of the income are residents, for tax purposes in blacklisted countries, territories or regions, as defined by Ministerial Decree of the Portuguese Minister of Finance; (ii) in the case of non-resident beneficiaries without a Portuguese-situs permanent PE who are held directly or indirectly in more than 25% by Portuguese resident entities (does not apply to EU and EEA residents, provided that, in the latter case, the resident State of the beneficiary is subject to administrative tax cooperation duties equivalent those in place EU).

2) Tonnage tax and special regime applicable to seafarers

Portugal introduced an elective tonnage tax and a special regime applicable to seafarers, the main characteristics of which are as follows:

Tonnage tax – the tonnage tax applies, upon a taxpayer's election, to income from qualifying activities derived by ships or vessels which (i) have a EU pavilion, (ii) are strategically and economically managed from a EU or EEA country and (iii) at least 50% of the seafarers used by eligible ships and vessels are resident for tax purposes in Portugal, EU, EEA or in a Portuguese-speaking country.

Qualifying activities and income are defined in a closed list: maritime transport of goods and passengers, on-board sale of goods and services ancillary to maritime transport, including hotel, restaurant, entertaining and commerce activities supplied inside an eligible ship or vessel, short term working capital investment income derived from treasury instruments related to qualifying activities, on-board advertising and surrendering of advertising space in qualifying ships or vessels, ship brokerage activities (qualifying ships and vessels only), disposal of assets used in maritime transport, sea bed research activities, sea bed wire and pipeline placement activities, maritime crane activities, strategic, commercial, technical operational and crew management services for qualifying ships and vessels, sea towage activities, provided that 50% of the annual activities are considered maritime transport (only applicable to such qualifying maritime transport activities), sea dredging activities, provided that 50% of the annual activities are considered maritime transport (only applicable to such qualifying maritime transport activities), chartering activities, provided that the taxpayer controls the operations and the crew, indemnities and subsidies received in relation to maritime transport activities.

Qualifying activities expressly exclude: regular transport of passengers, including fluvial or inner-water transport (unless when carried out in Azores or Madeira), activities unrelated to the transport of goods and services (e.g. fishery), commercial services supplied in harbors and ports, namely loading and unloading, piloting and towage services, museology and maritime conservation activities, viability studies, exploration and extraction of natural resources, use of ships or vessels permanently anchored, recreation activities including sightseeing and scuba diving, educational and social activities, other activities ancillary to excluded activities.

Taxpayers who own ships or vessels registered outside the EU / EEA may also apply for the special regime, provided they fulfill each one of the following requirements (i) at least 60% of their net tonnage has a EU / EEA pavilion; (ii) are able to show that the strategic and commercial strategy of

their ships and vessels is defined in the EU / EEA; comply with European protection, safety, environment and workforce standards.

Entities whose ships and vessels are surrendered by third parties (with or without crew) may also benefit from this regime, provided that the following conditions are met (i) they comply with all the general requirements described above; (ii) tonnage surrendered by third parties does not represent more than 75% of the entire tonnage explored by the taxpayer; (iii) income from tonnage surrendered by third parties is not higher than four times the income derived from ships and vessels owned by the taxpayer.

The tax base is determined according to a regressive system, based on daily net tonnage: up to 1000 net tons (€0.75, per 100 net tons / daily), from 1001 to 10000 tons (€0.60, per 100 net tons / daily), from 10001 to 25000 (€0.40, per 100 net tons / daily), higher than 25001 (€0.20, per 100 net tons / daily). The regular CIT 21% rate applies.

Special regime for seafarers – seafarers and crews used in ships and vessels eligible for the new tonnage tax are exempt from PIT; they will further be eligible for reduced social security contributions (a reduced rate of 6% applies, 4.1% borne by the employer and 1.9% be the employee).

3) **Corporate Restructuring incentives -** Budget law 2019 extended the scope of automatic exemption for stamp duty, property taxes and other emoluments otherwise levied on corporate divisions. Before budget law, as a rule, the applicability of such benefits would require ministerial approval.

4) **Portugal and Angola signed a DTT and a Mutual Assistance Convention**

Angola and Portugal signed a Double Tax Treaty (DTT), a long-awaited international tax development for both countries. While Angola signs its second DTT (the first one was with UAE and is not yet in force), Portugal will finally complete its treaty network with the Portuguese-speaking world, while becoming the first European country to sign a DTT with Angola. This development is particularly relevant as it is expected that a substantial part of the investment in Angola may now be articulated via Portugal. The main features of the new DTT are:

i. **UN Model influence -** The DTT is modeled under the recent 2017 update to the UN Model Tax Convention. It encompasses, *inter alia,* an extended Permanent Establishment (PE) definition (e.g. lower thresholds applicable to construction-site PEs, a services PE provision and a strengthened dependent agent definition), source taxation for indirect transfers in relation to land-rich companies, and specific source rules for technical fees. Natural resources exploration activities may give rise to a PE if the equipment is used in the source country for a period exceeding 30 days, a not uncommon threshold which, however, is not in the UN Model.

ii. **The DTT switches on the application of relevant Portuguese domestic law provisions.** The Portuguese unilateral regime applicable to cross-border transactions, chiefly after the Corporate Income Tax Reform of 2014, extend certain rules where the counterparty is a resident of a country with which Portugal has entered a DTT. No reciprocity is required. These provisions include a dividend withholding tax exemption applicable in the case of qualifying interests (currently 10% vote or capital) held in Portuguese-resident entities for at least 1 year, as well as a 100% dividend received deduction granted to Portuguese-situs PEs of companies resident in a country that has a DTT in force with Portugal.

iii. **Reduced withholding tax rates apply to dividend, interests and royalty income.** The DTT establishes maximum withholding tax rates for dividend, interests and royalties as follows:

Dividends	8% / 15%[1]
Interest	10%
Royalties	8%

iv. **Withholding tax applies to certain fees charged for technical services.** Coherently with the established in the 2017 UN Model, a 5% withholding tax rate applies to certain outbound payments in exchange for certain technical services. The term "technical services fees" includes any payment in consideration for any service of a managerial, technical or consultancy nature, unless the payment is made (i) to an employee of the person making the

[1] The 8% rate applies when the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganization, such as a merger or divisive reorganization, of the company that holds the shares or that pays the dividend. The 15% rate applies to all other cases.

payment, (ii) for teaching in an educational institution or for teaching by an educational institution (iii) by an individual for services for the personal use of another individual. It is not required that the technical services are provided within the borders of the source State.

v. **Source country taxation of (certain) indirect transfers.** Following a recent UN and OECD trend, the DTT provides for source country taxation of direct and indirect transfers of interests in companies and other entities, such as partnerships and trusts, that derive, at any time during the 365 days preceding the alienation, more than 50 per cent of their value from immovable property located in the source country. Indirect transfers via the disposal of interests in entities resident, for tax purposes, in a third country are also within the scope of this provision.

vi. **DTT benefits subject to a Principal Purposes Test.** Coherently with the Portuguese option under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), the DTT includes a simplified version of the Entitlement to Benefits clause, structured as a principal purpose test (PPT).

vii. **DTT benefits specifically denied in certain cases involving source payments attributable to a third country PE benefitting from a resident State exemption.** Following the UN model, the DTT benefits may be excluded in the case of source State payments attributable to a PE located in a third State, where the residence State exempts the income of such PE. This is particularly relevant as the Portuguese Corporate Income Tax establishes an optional regime which, under certain circumstances, exempts the income derived by a foreign PE of a Portuguese entity. This rule, however, will not apply if the income derived from the other State emanates from, or is incidental to, the active conduct of a business carried on through the PE (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively). It is further possible to exclude the ordinary effect of this rule upon a special request to the competent authority.

viii. **Tax Sparing clause applicable for 7 years.** Under the DTT, Portugal has agreed on a matching credit provision under which it will allow, as a deduction, the amount of tax which Angola could have imposed in accordance with its general legislation as limited by the Convention, in the absence of certain tax concessions granted to promote economic development. This provision does not apply to income derived by or from entities undertaking banking, insurance, holding and leasing activities.

ix. **Oil & Gas activities excluded.** The DTT does not limit, in any possible way, the right of the Contracting States, or of any local authority thereof, to apply their domestic legislation and regulations in relation to the taxation of income or profits derived from hydrocarbons within their territory.

x. **DTT in initially force for 8 years (renewable).** The DTT will be in force for an initial period of 8 years which will be renewed for equal consecutive periods, unless the DTT is terminated by one of the contracting States. After the initial period of 8 years a contracting State may terminate the DTT by giving notice to the other contracting State of termination at least six months before the end of any calendar year.

The agreement on mutual administrative assistance and cooperation on the recovery of tax-related claims covers the following matters:

i. Simultaneous tax audits and participation in tax audits held in the other Contracting State;
ii. Assistance on the recovery of claims relating to taxes as well as provisional measures (*providências cautelares*);
iii. Serving of documents.

5) REITS

Portugal enacted for the first time a REIT-like regulatory and tax regime (*Sociedades de Investimento e Gestão Imobiliária or "SIGIs").* SIGIs are formed as joint stock companies, with or without public subscription, with a minimum paid-up share capital of €5,000,000.00 and their governance model must include a supervisory board (*conselho fiscal*) and a statutory auditor (*revisor oficial de contas*) (or an audit firm which is not part of the supervisory board). Other joint-stock companies as well as other funds may be converted into SIGI's upon a quite simple procedure.

The corporate purpose of SIGIs must include at least one of the following: (i) Acquisition of property ownership rights, surface rights or other rights of an equivalent nature, provided that the property is used for leasing or other forms of economic exploitation; (ii) Acquisition of equity interests in other SIGIs or in companies with registered office in another EU/EEA Member State, provided that in the latter case such State is bound to administrative cooperation in the field of taxation equivalent to the

one established in the EU; (iii) Acquisition of equity interests corresponding to shares or to investment units of certain funds.

SIGIs may either directly manage or economically operate properties or enter into service agreements with third parties for the management or economic exploitation of such properties. SIGIs are not regulated vehicles, i.e. they are not under the supervision of the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários*) (*"CMVM"*).

SIGIs must distribute income within 9 months after the fiscal year end and distribute at least (i) 90% of their annual profits corresponding to dividends and income distributions from shares or units held and (ii) 75% of the remaining annual profits which are available for distribution under company law. Also, at least 75% of the net income resulting from the sale of assets allocated to the business of the SIGI should be reinvested in other assets allocated to the SIGI business within 3 years counted from their sale. Finally, the legal reserve of a SIGI cannot exceed 20% of the SIGI's share capital.

SIGIs shares must be admitted to trading in a regulated market or in a multilateral trading system within one year following incorporation or conversion effective date. It is further required that at least 20% of their capital is held by investors holding less that than 2% of voting rights the SIGI.

It is required that at least (i) 80% of SIGI's asset value corresponds to property that matches the SiGI´s mandatory corporate purpose mentioned above and (ii) 75% of the total value of SIGI's assets corresponds to rights over properties subject to lease agreements or other form of economic exploitation. These asset composition requirements must be met as from the second year following the incorporation of the SIGI. The abovementioned rights must be held for at least three years following their acquisition and SIGIs' indebtedness may not exceed, at all times, 60% of SIGI's total asset value.

The SIGI-Law does not include a specific tax regime. It applies the same tax regime applicable to collective investment vehicles, i.e. SIGIs, although technically subject to CIT, should be exempt from corporate income tax arising from investment, rental income and capital gains from the disposition of real estate. SIGI's resident shareholders will be subject to withholding tax (28% for individuals and and 25% corporate investors). A 10% withholding tax rate applies to income derived by non-residents.

6) BEPS

Portugal transposed ATAD I during the first semester of 2019. The amendment is effective retroactively as of January 1. Portuguese law already covered some of these measures and, therefore, it is arguable that there would be a need to amend certain provisions like the CFC rule or the interest barrier rule. The most worth noting changes are:

Interest limitation rule – the definition of net interest is supplemented by an express reference to certain debt instruments and a new methodology to calculate tax EBIDTA is adopted (the starting point for the computation has switched from the accounting profit to taxable profit). Under the new rule, banks, pension funds and insurance companies are still excluded. No carve-out rules for multinational groups and long-term infrastructure projects has been enacted.

CFC rule – the new law established amendments to key provisions of this regime including the definition of a relevant shareholding, definition of CFC, rules governing the computation of CFC profits, deductibility of losses, rules governing the disposal of a CFC and the applicable terms to carve-out EU companies qualifying as CFCs.

- *Relevant shareholding* – a relevant shareholding is exclusively defined as a shareholding that grants a 25% interest in vote or value of the CFC (a 10% rule applicable to situations where 50% or more of vote or value was held by Portuguese residents no longer applies);
- *Definition of CFC* - a CFC is defined as an entity resident in a blacklisted country, region or territory (as in the previous version of the rule) and / or an entity whose CIT effectively disbursed is 50% or lower than the CIT that would have been paid under the Portuguese CIT code (before this change a minimum 12.6% headline rate test would apply). The substantial activity test that would previously cure the CFC status is also amended and replaced by an approach which considers exclusively the type of income derived by the CFC (income derived from certain passive income cannot exceed 25% of total income) and no longer uses a tainted income approach to block the applicability of the curing provision.
- *Deductibility of losses* – loss making CFCs will be able to carry forward losses for a period of 5 years, thus reducing the amount of future profits to be taxed under the CFC rule;
- *Disposal of a CFC* – the new law determines that resident entities with past CFC inclusions that fully or partially dispose of an interest in a CFC will be able to recover the amount

previously taxed via a reduction of the realization amount considered when computing a capital gain or loss.

- *EU carve-out* – the rule carving-out CFCs established in the EU or EEA is supplemented with a detail of what should be considered the exercise of an economic activity. As such, it is now expressly required that the CFC is engaged in an economic activity and uses in the course of such activity, *personnel, equipment, assets and premises*.

The new rule, despite the attempt to close certain gaps that had been identified in the Portuguese CFC rule over the past years, does not address satisfactorily some of these issues. In addition, some of the Portuguese options are not necessarily in line with ATAD I. It further creates certain structural problems that are likely to require additional clarification from the tax authorities, if not another legislative amendment. The following is a short summary of some of these issues:

i) The new rule dramatically widens the scope of the CFC rule, a circumstance which is likely to increase compliance and control costs;

ii) The rule is no longer aligned with the participation exemption. As such, it will not be infrequent that CFC income, once distributed, will be exempt;

iii) Contrary to the directive, Portugal did not enact an indirect credit for the taxes paid by the CFC. Rather it kept a deduction. This is clearly a violation of the directive likely to generate litigation.

iv) If the credit is enacted and the Portuguese law is aligned with ATAD I in this respect, the abovementioned disruption between the participation exemption and the CFC, will create the need to recapture the credit;

v) The extensive net of attribution rules that was maintained from the previous version of the law combined with such an encompassing version of the CFC falls short in terms of rules necessary to avoid double inclusions. This will certainly create perplexities and further litigation is expected.

Optional exemption on profits attributable to foreign-situs PE – the minimum taxation threshold of 12.6% (headline rate) is replaced by a new requirement in line with the amendments to the CFC rule, i.e. that CIT effectively paid is 50% or lower than the CIT that would have been paid under the Portuguese CIT code. In addition, the law no longer determines that the reattribution of assets of a foreign-situs PE should be made at fair market value.

Inbound relocation of companies and reattribution of the assets of foreign-situs permanent establishment - Mirroring an amendment to the foreign-situs PE rules, the reattribution of assets and liabilities of a foreign-situs, except where otherwise determined in the law, will take place at net book value, provided that such net book value is lower than the fair market value. Similarly, in the case of entities transferring their seat or place of effective management into Portugal, and unless a specific provision otherwise determines, the acquisition cost of their assets and liabilities will be, upon and by the time such transfer occurs, their net book value, provided that such net book value does not exceed the fair market value.

This rule will not apply in the following situations: (i) assets which had been attributed to a Portuguese-situs PE of a foreign entities prior to the transfer; (ii) entities whose seat or place of effective management was located in Portugal prior to the transfer and were not considered residents of another State under a DTT; (iii) entities who under a DTT were already considered Portuguese residents prior to the transfer and (iv) entities that were considered residents of another State after the transfer under the provisions of a DTT.

The law establishes a very relevant exception to all these general rules: in the case of assets and liabilities originating from a EU State, as well as in the case of entities transferring their seat or place of effective management from a EU State, taxpayers may consider as "entry value" the value of such assets used in the other EU State for purposes of determining their corporate income tax in such State.

Exit taxes – payment rules amended. Under the new rules it is no longer possible to differ the payment of CIT due upon the exit to the moment a realization event occurs (i.e. a disposal of assets or assimilated event). As such, taxpayers may either pay the exit tax in full upon the transfer or file an election to apply the instalment method under which their exit tax liability will be satisfied in 5 equal annual instalments.

The law, however, introduced also certain conditions, the fulfilment of which will determine that the instalment method ceases immediately to apply: a) the assets and liabilities cease to exist, are on-transferred or no longer used in the entity´s activity (immediate payment will be required in proportion to the value of such assets and liabilities); b) the assets and liabilities are legally or materially transferred to a country or territory outside the EU /EEA, provided that, in the latter case, the EEA State where the assets are transferred to is bound to mutual assistance obligations regarding the collection of taxes equivalent to those established in Council Directive 2010/24/EU, of March 16

2010 (immediate payment will be required in proportion to the value of such assets and liabilities); c) the tax residency of an entity is transferred to a third State outside the EEA which is not bound to mutual assistance obligations regarding the collection of taxes equivalent to those established in Council Directive 2010/24/EU, of March 16 2010 or d) the entity files for bankruptcy.

New Language to the General anti-abuse rule (GAAR) introduced – The Portuguese GAAR adopted new language that follows closely the ATAD language. The practical impact of such change, however, i.e. the extent to which the new wording will lead to different conclusions compared to its predecessor, is yet to be determined.

The new wording of the GAAR, similarly to that of the ATAD Directive, provides that an arrangement or a series of arrangements put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the objective or purpose of an applicable tax law and when such arrangement or series of arrangements are used with abuse of legal forms or are not considered genuine, taking into consideration all relevant facts and circumstances, will be disregarded for tax purposes, with the taxation being levied in accordance with the rules that would apply to the transactions, taking into account their economic substance or reality. An arrangement or a series of arrangements is not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. An arrangement may comprise more than one step or part (step transaction doctrine).

Entry into force and transitional rules - the law transposing ATAD entered into force on May 4, 2019. Under a transitional rule, taxpayers that had previously elected to defer the payment of tax to the moment a realization event occurs are grandfathered by the new law.