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Corporate Tax 2023

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Portugal: Law & Practice
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Law and Practice

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1. Types of Business Entities, Their Residence and Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses can choose from several types of corporate forms when setting up their operations in Portugal, with the Private Limited Liability Company (*Sociedade por Quotas* or Lda.) and the Public Limited Liability Company (*Sociedade Anónima* or S.A.) standing out as the most common vehicles.

Private Limited Liability Company

There is no minimum share capital requirement, and the share capital is represented by "quotas" owned by at least two partners ("quotaholders"). The responsibility of the quotaholders is limited to the company's capital, unless otherwise is provided in the company's articles of association.

A Single Member Private Limited Liability Company (*Sociedade Unipessoal por Quotas* or *Unipessoal, Lda*.) may be incorporated by a single quotaholder or may result from the transformation of a standard Private Limited Liability Company into a Single Member Private Liability Company.

Public Limited Liability Company

It takes at least five individual or corporate founders to set up a Public Limited Liability Company, and a minimum share capital of EUR50,000. The liability of the shareholders is limited to the amount of capital they have invested in the company.

Both forms of company are taxed as separate entities from their shareholders. They must calculate the Corporate Income Tax (CIT) due under the self-assessment method, by filing a CIT return and a supporting accounting tax report on an annual basis.

1.2 Transparent Entities

The CIT Code establishes tax transparency rules applicable to the following:

- companies incorporated in a civil corporate form with a commercial capacity;
- "professional service firms" (companies engaged in listed professional activities); and
- companies established for the passive administration of certain assets, values or goods held for the benefit of their shareholders.

Complementary Groups of Companies (*Agrupamento Complementar de Empresas* or ACE) and European Economic Interest Groups (*Agrupamento Europeu de Interesse Económico* or EEIG) are incorporated joint ventures for companies to pursue common economic interests, and to which the tax transparency rules apply (see **3.2 Individual Rates and Corporate Rates**).

1.3 Determining Residence of Incorporated Businesses

The residence of a business incorporated in Portugal is determined by the location of its legal seat or place of effective management.

1.4 Tax Rates

The general CIT rate in Portugal is 21%, reduced to 14.7% in the Autonomous Region of Madeira and the Autonomous Region of the Azores.

On the Portuguese mainland, a reduced 17% CIT rate is applicable to the first EUR50,000 of taxable profits for SMEs and small-medium capitalisation companies (Small Mid-Cap), with the general CIT rate applying to the excess.

The CIT rate may be further reduced to 12.5% on the first EUR50,000 of the taxable amount for SMEs and Small Mid-Caps operating and having their effective management in inland territories of mainland Portugal, with the general CIT rate applying to the excess.

A Municipal Surtax (*Derrama Municipal*) may also be applicable. It varies between 0% and 1.5% on the annual taxable profit, depending on the municipality in question.

A State Surtax (*Derrama Estadual*) applies at the following rates:

- 3% on the part of taxable profits between EUR1.5 million and EUR7.5 million;
- 5% on the taxable profits between EUR7.5 million and EUR35 million; and
- 9% on taxable profits exceeding EUR35 million.

Certain expenses incurred by entities subject to CIT are subject to a penalty tax (known as autonomous taxation or *Tributação Autónoma*), at varying rates.

Other reduced rates apply in the Autonomous Region of Madeira and the Autonomous Region of the Azores.

Finally, profits earned by tax transparent entities are attributed and taxed in the hands of their individual or corporate members, under the applicable Personal Income Tax (PIT) and CIT provisions.

Individuals will be subject to PIT at progressive rates up to 48%. A solidarity surtax may also apply, at the following rates:

- 2.5% on income between EUR80,000 and EUR250,000; and
- 5% on income exceeding EUR250,000.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

The calculation of the taxable profit corresponds to the accounting net income for the period, plus the positive and negative variations to a company's net worth during the same period not reflected in that result, adjusted in accordance with the provisions of the CIT Code. The adjustments include:

- corrections relating to derivative instruments;
- transfer pricing adjustments;
- imputation of profits earned by non-resident entities subject to a privileged tax regime;
- unrealised capital gains and losses, and capital gains with reinvestment purposes;
- limitation on the interest deductibility;
- donations valued beyond the legal limits;
- undocumented expenses and improperly documented expenses;
- illegal expenses;
- deferred taxes;
- excessive depreciation and/or amortisation;
- patent box regimes.

Indirect methods to determine the taxable profit may be applied if certain criteria are met.

2.2 Special Incentives for Technology Investments

Patent Box

The Patent Box grants a deduction corresponding to 85% of the income derived from contracts concerning the disposal or temporary use of cer-

tain industrial property rights (patents, drawings or industrial models and copyright on computer software). This includes income from the violation of such rights, upon the fulfilment of certain conditions established in the CIT Code.

For this purpose, income is defined as the net positive balance between the revenues and gains derived as consideration from the disposal or use of qualifying industrial property rights and the R&D expenses or losses incurred or borne in the same period by the taxpayer in connection with the industrial property right from which the gain is obtained.

The Patent Box rules do not apply to any services supplied that are ancillary to a qualifying disposal or temporary use of industrial property.

SIFIDE II

The Portuguese SIFIDE II programme (the System of Tax Incentives for Business Research and Development) provides a tax credit for investments arising from R&D.

Portuguese tax resident companies carrying out commercial, industrial or agricultural activities, and non-resident companies with a permanent establishment in Portugal, are allowed to benefit from CIT deductions arising from the following eligible expenses:

- 32.5% of the R&D expenses incurred (increased by 15% in the case of SMEs); and
- an incremental rate of 50% over the difference between the increase of R&D expenses of the relevant year and the average R&D expenses incurred in the previous two years, up to the limit of EUR1.5 million.

If it is not possible to deduct the total amount of the calculated benefit, the excess will be converted into a tax credit, which may be carried forward for eight years.

2.3 Other Special Incentives

Portuguese tax legislation provides for other special incentives that apply to particular industries or transactions.

Collective Investment Undertakings (CIUs) – Organismos de Investimento Coletivo

Collective investment undertakings in securities or in real estate take the form of investment funds or investment companies (incorporated in the form of public limited liability companies).

CIUs are subject to CIT at the general 21% rate, although they are exempt from the municipal and state surtax. They also benefit from a CIT exemption on their usual main sources of income (investment income, rental income and capital gains), unless the income is sourced in a blacklisted jurisdiction.

The taxation of income thus takes place at the level of the holders of units in the CIU, as follows:

- income obtained by resident investors is subject to PIT at the rate of 28%, or to CIT at the general rates, for corporate investors; and
- income obtained by non-resident investors without a permanent establishment in Portugal is taxed at the rate of 10% for income deriving from real estate investment vehicles – a tax exemption is applicable to all other items of income.

Incentive for the Capitalisation of Companies (ICE) – Incentivo à Capitalização das Empresas

Introduced by the State Budget for 2023, this incentive provides for a tax deduction from the taxable income of 4.5% of the amount of

an eligible company's net increases in equity (increased to 5% if the company qualifies as an SME or Small Mid-Cap).

The qualifying net equity increases result from:

- contributions in cash made within the scope of the company's incorporation or an increase of the beneficiary company's share capital;
- contributions in kind made within the scope of an increase in the company's share capital that corresponds to the conversion of credits into equity;
- premiums for issuing securities; and
- taxable profits that are invested in retained earnings or, directly, in reserves or in the increase of the company's share capital.

Furthermore, in each tax period, the deduction cannot exceed EUR2 million or 30% of the taxable earnings before interest, taxes, depreciation and amortisation (EBITDA), whichever is higher. The portion that exceeds the limit may be carried forward for a period of five years.

Exemptions on Debt Instruments

Under Decree Law 193/2005, investment income and capital gains arising from qualifying debt instruments issued by Portuguese entities are exempt from Portuguese income tax as long as the beneficiaries are:

- central banks and government agencies;
- international organisations recognised by the Portuguese government;
- entities resident in a country or jurisdiction that has executed a Convention for the Avoidance of Double Taxation (CDT) or an agreement that provides for the possibility of the exchange of information; or
- entities without a residence, head office, effective management or permanent establishment in Portugal to which the income is attributable, and that are not domiciled in a blacklisted jurisdiction.

These rules cover debt instruments relating to public and non-public debt securities, including securities of a monetary nature (treasury bills and commercial paper), perpetual bonds, convertible bonds, other convertible securities, and qualifying tier 1 and tier 2 capital instruments, regardless of the currency in which this debt is issued. These instruments must be integrated in a centralised system managed by a Portuguese resident entity or by a management entity of an international clearing system established in the EU/EEA, provided that there is administrative co-operation in the field of taxation equivalent to that established within the EU.

Venture Capital Funds (VCFs) – Fundos de Capital de Risco

Income earned by VCFs set up and operating under Portuguese law is exempt from CIT.

Income paid or placed at the disposal of investors (unitholders) by the funds, by distribution or redemption, is generally subject to PIT or CIT at the rate of 10%, unless the unitholders are (i) entities that are exempt in respect of investment income, or (ii) non-resident entities without a permanent establishment in Portugal to which the income is attributable, unless they are resident in a blacklisted jurisdiction or are held, directly or indirectly, more than 25% by resident entities.

There is a possibility for individual unitholders to exempt 50% of the dividend income if they elect to aggregate the distributed income and subject it to progressive rates (see **1.4 Tax Rates**).

Finally, a 10% rate applies on the positive balance between gains and losses deriving from the disposal of the units when the unitholders are non-resident entities to which the exemption further described in **2.7 Capital Gains Taxation** does not apply, or are PIT taxpayers resident in Portugal who do not obtain the income from a commercial, industrial or agricultural activity and do not opt for aggregation.

Incentives for Non-resident Financial Companies

A CIT exemption applies to interest payments made by resident credit institutions to non-resident financial companies in respect of loans and swap transactions, provided that the non-resident entity:

- does not have a permanent establishment in Portugal to which the income is attributable;
- is not established in a blacklisted jurisdiction; and
- is not substantially held by resident entities.

In addition, gains obtained by non-resident financial institutions on securities repo operations with resident financial institutions are exempt from CIT, provided the gains are not attributable to the Portuguese permanent establishment of a non-resident entity.

2.4 Basic Rules on Loss Relief

The State Budget for 2023 introduced some important changes, including:

- tax losses may now be carried forward without a time limit (applicable to tax losses registered in 2023 onwards, and to tax losses carried forward from tax periods prior to 1 January 2023 that have not yet expired); and
- losses may be offset against 65% of the taxable profit.

Carry-back is not allowed.

Under anti-loss trafficking rules, tax losses carried forward will be forfeited upon a change in direct ownership of at least 50% of shareholding or voting rights, unless the operation has not been carried out for tax avoidance purposes (which occurs when the operation has valid economic reasons).

Specific safe harbours are included for intra-group transfers of shares (eg, conversion of a direct shareholding into an indirect shareholding or vice versa, or when the change of ownership occurs between companies more than 50% of which are directly or indirectly held by the same entity).

These rules are not applicable to non-resident entities, except when they have a permanent establishment in Portugal to which the income and/or losses obtained in Portugal may be attributed. Therefore, in cases where non-resident entities do not have a permanent establishment in Portugal, they are taxed only on their Portuguese source income (ie, the balance between capital gains and losses from a Portuguese source).

2.5 Imposed Limits on Deduction of Interest

There is a general limitation on the deductibility of net financing expenses up to the higher of the following limits:

- EUR1 million; or
- 30% of the company's tax-adjusted EBITDA, whichever is higher.

The interest barrier rules also provide for a denied interest deduction and the carry-forward

of unused EBITDA for a period of five years (on a first-in, first-out basis).

In addition, and in line with **2.6 Basic Rules on Consolidated Tax Grouping**, where the tax group rules (*Regime Especial de Tributação dos Grupos de Sociedades* – RETGS) apply, there is the option to consider these rules at the level of the group, with some specificities regarding pre-group or post-group taxable years.

As regards shareholder loans, transfer pricing rules should apply and interest charged should be at arm's length. Unless these rules apply, the maximum deductible interest will be equivalent to EURIBOR 12M + a 2% spread, except in the case of SMEs, where the spread is fixed at 6%.

2.6 Basic Rules on Consolidated Tax Grouping

RETGS is an optional regime for the aggregation (and not consolidation) of tax losses and profits of a group of companies. RETGS may be applicable whenever a "parent company" holds, directly or indirectly, at least 75% of another company, or when companies share capital and 50% of voting rights for more than one year, except when the subsidiary is newly incorporated.

Electing to apply RETGS is only possible if certain cumulative requirements are met regarding the parent company and the remaining group companies. These rules cease to apply when any of the parent company requirements are no longer fulfilled, or when the taxable profits of the subsidiary companies (member companies) are determined according to indirect methods.

Moreover, the fact that the parent company becomes controlled by another Portuguese company does not necessarily imply the loss of the possibility to apply these rules. The parent company can be resident in the EU (horizontal grouping). Specific rules apply if certain operations occur during the application of the RETGS, such as mergers, etc; specific rules also apply to the carry-forward of losses during the RETGS.

2.7 Capital Gains Taxation

Capital gains or losses are assessed based on the difference between the sale price (after deducting inherent costs of the sale) and the adjusted acquisition value, which is calculated by applying a monetary devaluation indexation coefficient for the year of acquisition, when applicable.

However, under the participation exemption regime, capital gains or losses derived from the disposal of shares are exempt from taxation if the following requirements are met.

- The seller holds directly, or directly and indirectly, a minimum of 10% of the share capital or voting rights of the subsidiary for a minimum period of one year.
- The seller is not subject to tax transparency rules.
- The entity whose shares are transferred:
  - (a) is subject to and not exempt from CIT in Portugal;
  - (b) if resident in the EU, is subject to and not exempt from a corporate income tax mentioned in the Parent-Subsidiary Directive (Directive 2011/96/UE); or
  - (c) if resident outside the EU, is subject to and not exempt from a tax similar to Portuguese CIT and the nominal rate is not below 60% of the Portuguese CIT (ie, 12.6%). This limitation does not apply if the distributing subsidiary qualifies as an "active foreign company" under controlled foreign corporation (CFC) rules (see **6.5**

Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules).

- The entity whose shares are transferred is not resident or domiciled in a blacklisted jurisdiction.
- The gains derived do not relate to shares or corporate rights in Portuguese companies whose assets consist in more than 50% of immovable property located in Portugal (acquired in or after 2014), unless that property is used in connection with an agricultural, industrial or commercial activity (other than real estate buying and selling activity).

In addition, Portuguese tax law provides for a domestic exemption, which is available for non-resident entities without a permanent establishment in Portugal deriving capital gains from the sale of shares, provided that the following conditions are met.

- The seller is not held, directly or indirectly, more than 25% by a Portuguese resident company, except when the non-resident entity:
  - (a) is resident in another EU member state, an EEA member state that is bound to administrative co-operation in the area of taxation equivalent to that established within the EU or a state with which a CDT providing for the exchange of information has been concluded and is in force;
  - (b) is subject to and not exempt from a corporate income tax mentioned in the Parent-Subsidiary Directive EU or from a tax similar to Portuguese CIT and the nominal rate is not below 60% of the Portuguese CIT (ie, 12.6%);
  - (c) holds directly or indirectly a stake of at least 10% in the share capital or voting rights of the Portuguese entity whose shares are transferred for a minimum of one year prior to disposal; and
  - (d) the non-resident entity is not part of an artificial arrangement, or a series of artificial arrangements, with the main purpose, or with one of the main purposes, of obtaining a tax advantage.
- The seller is not resident in a blacklisted jurisdiction.
- The gains derived do not relate to shares or corporate rights in Portuguese companies whose assets consist in more than 50% of Portuguese-situs immovable property (with certain specificities).

Furthermore, the CIT Code establishes a reinvestment relief mechanism where up to 50% of the positive difference between capital gains and capital losses can be exempt from taxation, provided the sale proceeds are fully or partially reinvested in the year prior to the disposal or before the end of the second following year in the acquisition, manufacture or construction of the fixed, intangible and biological non-consumable assets.

In the case of non-compliance with the established rules, the defaulted CIT amount will be added to the taxable profit of that tax year, plus 15%.

2.8 Other Taxes Payable by an Incorporated Business

Other taxes may be applicable to a transaction, as follows.

- Value-Added Tax (VAT): as a rule, the sale of goods and the provision of services is subject to VAT at the standard rate of 23%. Reduced rates apply to specific goods or services and in the autonomous regions.

- Stamp Duty: this tax is due on acts, contracts, documents, titles, books, papers and other facts taking place in Portugal, which are not subject to or are exempt from VAT, at diverse rates as provided in the General Table annexed to the Stamp Duty Code.
- Real Estate Transfer Tax (RETT): this tax is due upon the acquisition of real estate and applies to the taxable value of the building or property (VPT) or the price paid for the property, whichever is higher. The applicable rates vary according to the type of property. In addition, the acquisition of more than 75% of the share capital of a company in which the value of its assets is comprised, directly or indirectly, in more than 50% by immovable property located in Portugal, which is not directly assigned to an agricultural, industrial or commercial activity, excluding the sale and purchase of immovable property, is subject to RETT.
- Other indirect taxes: The import and/or trading of certain products in Portugal are subject to other indirect taxes, including excise duties. These products include petroleum and energy, tobacco, alcohol and alcoholic beverages, and vehicles.

2.9 Incorporated Businesses and Notable Taxes

The mere holding of property in Portugal entails the annual payment of Municipal Property Tax (MPT), which is due over the VPT. The MPT rates for a property depend on the Municipality where it is located. For urban properties, the rates can range between 0.3% and 0.45%. In contrast, rural properties are subject to a fixed MPT rate of 0.8%.

The holding of property may also be subject to the MPT Surtax, which is due annually and levied at a 0.4% tax rate on the sum of the taxable values of the properties owned by the corporate taxpayers, as reported on 1 January of each year. No MPT Surtax applies whenever the real estate properties are registered for commercial or industrial purposes, or to render services.

There are also sector-specific contributions applicable to certain industries.

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses

Most closely held local businesses usually operate in corporate form.

3.2 Individual Rates and Corporate Rates

As discussed in **1.2 Transparent Entities**, professional service firms may be subject to the tax transparency rules.

For these purposes, “professional service firms” are non-public companies engaged in listed professional activities in which all shareholders perform the same type of professional activities (doctors or lawyers, for example). Their shares should be held by five or fewer shareholders for more than 183 days per tax year, and more than 75% of the income must be derived from professional activity. In addition, at least 75% of share capital must be held by professionals who work wholly or partly through the company.

Taxable profits are calculated at the corporate level and, nevertheless, are subject to shareholder-level taxation as business income (subject to the progressive PIT rates outlined in **1.4 Tax Rates**).

3.3 Accumulating Earnings for Investment Purposes

If a closely held corporation is located in a blacklisted jurisdiction, CFC) rules may apply.

CFC income is attributed to individuals in proportion to the interest held and is therefore taxed as business income if that interest is held as a business activity; it is taxed as investment income in all other cases. For more details on CFC rules, see **6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules**.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Capital gains obtained by resident individuals from the sale of shares are taxed at a flat rate of 28%. However, if the shares are issued by a micro or small-sized company, a 50% exemption applies and therefore the capital gains will be taxed at an effective rate of 14%. Alternatively, the taxpayer may opt to aggregate the gains with other taxable income and become subject to tax at progressive rates (as outlined in **1.4 Tax Rates**).

Dividends received by resident individuals are subject to a flat rate of 28% (35% if paid by a company that is resident in a blacklisted jurisdiction). However, the taxpayer may opt to aggregate the dividends with other taxable income and become subject to tax at progressive rates (as outlined in **1.4 Tax Rates**), in which case a 50% exemption applies to dividends distributed by Portuguese-resident companies or companies that are tax resident in an EU/EEA member state that are subject to and not exempt from a corporate income tax therein.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

The tax rules applicable to sales of shares and dividends from publicly traded corporations do not differ from the rules applicable to closely held corporations (see **3.4 Sales of Shares by Individuals in Closely Held Corporations**).

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

In general, dividends, interest and royalties paid by Portuguese resident companies to non-resident companies are subject to withholding tax at a rate of 25%. This is subject to an aggravated rate of 35% if the income is paid or placed at the disposal of accounts held by one or more holders on behalf of unidentified third parties, or to entities considered as tax residents in blacklisted jurisdictions.

Nevertheless, no tax is withheld on the distribution of dividends by Portuguese resident entities subject to and not exempt from CIT and not subject to the tax transparency rules when the Portuguese participation exemption regime is applicable. This occurs if the beneficiary of the income:

- is resident in another EU member state, in an EEA member state that is bound to administrative co-operation for tax purposes equivalent to the rules in force in the EU, or in a country with which Portugal has entered into a CDT that is in force and provides for the possibility of the exchange of information;
- holds, directly and/or indirectly, at least 10% of the share capital or voting rights of the distributing company and those shares have been held uninterruptedly during the 12

months prior to the distribution of the dividends; and
- is subject to, and not exempt from, a corporate income tax mentioned in the Parent-Subsidiary Directive EU or a tax similar to Portuguese CIT and the nominal rate is not below 60% of the Portuguese CIT (ie, 12.6%).

The withholding tax exemption also applies to dividends paid to a permanent establishment located in other EU or EEA countries of an entity that meets the mentioned requirements.

Regarding interest and royalties, a withholding tax is also available pursuant to the EU Interest and Royalties Directive (I&RD), provided the following requirements are met:

- the paying entity and the recipient of the income must be subject to and not exempt from corporate tax, and must be incorporated under one of the legal forms listed in the annex of the I&RD;
- both entities must be considered EU residents for CDT purposes;
- a direct 25% shareholding must be held by one of the companies in the share capital of the other, or a third company must directly hold at least 25% of the capital of both companies, and in any scenario the shareholding must be held for at least a two-year period; and
- the entity that receives the interest and/or royalty income must be its beneficial owner.

If the minimum holding period is not met, the beneficiary may apply for the reimbursement of the withheld tax within the two years following the respective payment.

The withholding tax exemption does not apply to the portion of interest and royalties that is not at arm's length.

The withholding tax exemptions for dividends, and interest and royalties, are not applicable if there is an arrangement, or series of arrangements, that are not genuine, whose main purpose, or one of its main purposes, is to obtain a tax advantage that defeats the object and purpose of eliminating the double taxation, and which are carried out with an abuse of legal forms or are not considered genuine, considering all relevant facts and circumstances.

An arrangement or series of arrangements is considered non-genuine when it is not carried out for valid economic reasons that reflect economic substance.

In these circumstances, these arrangements or series of arrangements are disregarded for tax purposes and taxation is carried out in accordance with the rules applicable to business or acts that correspond to the substance or economic reality and do not produce the intended tax advantages.

To benefit from the above-mentioned withholding tax exemptions, the beneficiary of the income must fulfil some formal obligations.

4.2 Primary Tax Treaty Countries

Portugal has entered into 79 CDTs, 78 of which are in force and one has been signed and is awaiting entry into force. The last CDT to enter into force was with Timor-Leste.

Foreign direct investment is generally made primarily from Spain, the Netherlands and Luxembourg, as these are the primary tax treaty countries used (Bank of Portugal statistics, 2021).

4.3 Use of Treaty Country Entities by Non-treaty Country Residents

The Portuguese Tax Authority (PTA) has an increased interest in international and cross-border tax issues, in order to bring down treaty shopping practices.

In fact, the PTA will challenge treaty shopping insofar as clauses limiting treaty benefits are included in the relevant tax treaties. This is the case for several tax treaties signed by Portugal.

For instance, the Protocol to the Portugal-Spain CDT, under certain conditions, limits the applicability of reduced rates or exemptions on dividends, royalties, interest and capital gains if the recipient of the income is held, directly or indirectly, more than 50% by a non-resident treaty investor.

With the approval of Council Directive 2021/0432 (the "Unshell Directive"), which will presumably enter into force on 1 January 2024, the PTA is expected to tackle the misuse of tax treaties signed with other EU states, regardless of the existence of specific CDT provisions. In particular, the applicability of those CDTs will be excluded in situations where entities are considered to lack economic substance (see **7.1 Overarching Anti-avoidance Provisions**).

4.4 Transfer Pricing Issues

Management fees, royalties and interest charged over financing are the main issues dealt with by inbound investors under Portuguese transfer pricing rules.

4.5 Related-Party Limited Risk Distribution Arrangements

Limited risk distribution arrangements concluded within multinational groups are frequently monitored by the PTA, and may also be covered by advance pricing agreements.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

No significant issue arises from local transfer pricing rules and their enforcement, to the extent that Portugal follows the OECD standards. However, there are differences in the PTA approach in certain practical aspects.

4.7 International Transfer Pricing Disputes

The PTA generally does not resort to mutual agreement procedures (MAPs) to settle international tax disputes.

According to the latest OECD information available, as of 31 December 2021 the PTA was dealing with 127 ongoing MAPs, only 65 of which were transfer pricing cases.

Of the 17 transfer pricing cases closed that year:

- 12 MAPs ended with an agreement fully eliminating double taxation; and
- two MAPs ended with unilateral relief being granted.

The remaining cases were denied (one), resolved via domestic remedy (one) or had another outcome (one).

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

Whenever the PTA adjusts the taxable profit of an entity, a correlative adjustment must be made

with regard to the taxable profit of its related party.

MAPs can be started to bring forward correlative adjustments to a taxpayer's taxable income in situations where a related entity that is resident in a different jurisdiction was subject to transfer pricing adjustments.

5.2 Taxation Differences Between Local Branches and Local Subsidiaries of Non-local Corporations

Local branches (permanent establishments) and local subsidiaries of non-local corporations are generally liable to tax on an equal footing. However, there are some issues that must be considered in the tax rules applicable to a permanent establishment of a foreign corporation, such as:

- no withholding tax should apply on payments made to the head office by the permanent establishment;
- general administrative expenses attributable to the permanent establishment are tax deductible, provided that the terms and conditions are at arm's length and the criteria are uniformly followed in the different tax periods; and
- payments made to the head office (eg, interest) by the permanent establishment may be considered non-deductible.

5.3 Capital Gains of Non-residents

Capital gains derived by non-resident entities from the sale of stock or other equity instruments in Portuguese companies are subject to a 25% CIT rate (no withholding tax applies) unless certain requirements are met (see **2.7 Capital Gains Taxation** for details on the CIT exemption).

Most of the CDTs entered into by Portugal preclude taxation from the sale of stock of Portuguese entities, provided that the seller does not have a permanent establishment. However, capital gains from the sale of real estate-rich companies are generally taxable in Portugal.

Indirect transfers of stock of Portuguese companies are generally outside the territorial scope of the Portuguese CIT rules, unless more than 50% of the value of the stock is derived, directly or indirectly through one or more interposed entities, from immovable property that is located in Portugal and allocated to a property trading activity at any time during the 365 days preceding the sale.

5.4 Change of Control Provisions

The Portuguese CIT Code includes several change of control provisions that could give rise to a tax impact.

- The anti-trafficking rules provide that tax losses carried forward will be forfeited upon a change in direct ownership of at least 50% of shareholding or voting rights if the sale was entered into with tax avoidance purposes. Specific safe harbours are included for intra-group transfers of shares.
- Under interest barrier rules, denied interest deductions and unused EBITDA carried forward will be forfeited upon a change in direct ownership of at least 50% of shareholding or voting rights.
- A change of ownership or voting rights may also lead to changes in the perimeter of a tax group, or may lead to a tax group ceasing to exist.
- Tax benefits of a contractual nature may be recaptured as a result of the change of ownership.

Except for capital gains taxation on indirect transfers of stock of Portuguese companies

(see **5.3 Capital Gains of Non-residents**), indirect changes of control do not generally trigger any tax impact.

5.5 Formulas Used to Determine Income of Foreign-Owned Local Affiliates

Portuguese entities are subject to the same rules on the determination of taxable income, regardless of whether they are local or foreign owned. Portuguese transfer pricing provisions also apply to both domestic and cross-border transactions between related parties.

The attribution of profits to Portuguese permanent establishments of non-resident entities is preferably made by means of the direct method, and subject to the principle of the force of attraction. However, this principle is restricted by CDTs, in which Portugal follows the pre-2008 OECD separate entity approach.

5.6 Deductions for Payments by Local Affiliates

Payments made to non-resident affiliates for management and administrative expenses are generally deductible if they relate to the local affiliate's business activity, if certain documentary formalities are met, and if the terms and conditions are at arm's length. The deductibility of payments to affiliates in blacklisted jurisdictions is subject to further requirements, such as providing proof that the transaction indeed took place and did not have an abnormal character.

5.7 Constraints on Related-Party Borrowing

Other than the application of transfer pricing provisions requiring that the terms and conditions are at arm's length, there are no tax constraints on related-party borrowing. Interest payments to affiliates in blacklisted jurisdictions are subject to an aggravated 35% withholding tax rate, and restrictions apply on its deductibility.

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

6.1 Foreign Income of Local Corporations

Portuguese resident companies are taxed on their worldwide income and expenses. All income is taxed under the same class and is subject to the same tax rates. However, Portugal has specific schedules (eg, dividends, capital gains and royalties) for specific tax regimes.

As a rule, international double taxation is eliminated through the application of the credit method, under which an ordinary tax credit is granted for any foreign sourced income that is included in the company's taxable basis.

The tax credit will correspond either to tax paid abroad or to Portuguese CIT due on the foreign income, net of direct and indirect costs related to such income, whichever is lower. The tax credit is calculated on a per country basis and may be carried forward for five years. Whenever a CDT is applicable, the tax credit is capped at the amount of tax payable pursuant to the CDT.

The Portuguese CIT Code also employs the exemption method for dividends (see **6.3 Taxation on Dividends From Foreign Subsidiaries**), capital gains from the sale of stock of non-resident entities (see **2.7 Capital Gains Taxation**) and profits made by foreign permanent establishments.

The exemption for profits of outbound permanent establishments is elective and covers all

permanent establishments in one jurisdiction for at least three years. The relevant definition of "permanent establishment" is either the one found in the applicable CDT or, if no CDT is in place, the domestic definition. The CIT exemption is applicable if the following requirements are met:

- the profits attributable to the permanent establishment are subject to and not exempt from a corporate income tax mentioned in the Parent-Subsidiary Directive (Directive 2011/96/UE) or, if resident outside the EU, a tax similar to Portuguese CIT and the nominal rate is not below 60% of the Portuguese CIT (ie, 12.6%);
- the permanent establishment is not located in a blacklisted jurisdiction; and
- the income tax effectively paid by the permanent establishment is not lower than 50% of the tax that would be payable in Portugal. This requirement is waived if the outbound permanent establishment meets the substance criteria of an "active foreign company" laid down by CFC rules (see **6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules**).

The application of the exemption is subject to clawback rules, as follows:

- the exemption does not apply to the foreign permanent establishment's profits up to the amount of the foreign permanent establishment's losses that were set off against taxable income of the Portuguese head office in the previous 12 years; and
- if the Portuguese head office elects to switch from the exemption method to the credit method, tax losses registered by the foreign permanent establishment will not be offsetable against the taxable income of the Portuguese head office up to the amount of the foreign permanent establishment's profits that benefited from the exemption in Portugal in the previous 12 years.

The clawback provisions also apply for the conversion of a foreign permanent establishment into a subsidiary.

6.2 Non-deductible Local Expenses

The tax treatment applicable to expenses borne by or attributable to the foreign permanent establishment follows a principle of symmetry. Accordingly, if a taxpayer has elected to apply the exemption method to a foreign permanent establishment's profits, expenses borne by the foreign permanent establishment are not tax deductible at the level of the Portuguese head office, regardless of whether they are incurred in Portugal or abroad.

6.3 Taxation on Dividends From Foreign Subsidiaries

Dividends distributed by foreign subsidiaries qualify as taxable income for the Portuguese shareholder and are therefore subject to the standard CIT rates (see **1.4 Tax Rates**).

Pursuant to the participation exemption regime, economic double taxation is eliminated through a CIT exemption if the following requirements are met:

- the Portuguese company holds directly, or directly and indirectly, a minimum of 10% of the share capital or voting rights of the distributing subsidiary;
- this stake is held uninterrupted during the year preceding the distribution or, if it has been held for a shorter time period, is maintained for the time necessary to complete that period;

- the Portuguese company is not subject to the tax transparency rules;
- the distributing subsidiary is subject to and not exempt from a corporate income tax mentioned in the Parent-Subsidiary Directive (Directive 2011/96/UE) or, if resident outside the EU, a tax similar to Portuguese CIT and the nominal rate is not below 60% of the Portuguese CIT (ie, 12.6%) – this limitation does not apply if the distributing subsidiary qualifies as an "active foreign company" under CFC rules (see **6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules**);
- the distributing subsidiary is not resident or domiciled in a blacklisted jurisdiction; and
- the dividends distributed are not a tax-deductible expense at the level of the distributing subsidiary.

The participation exemption regime is subject to a sector-specific anti-abuse provision, according to which the CIT exemption will not apply whenever there is an arrangement or series of arrangements which is not considered genuine, having been carried out for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object and purpose of eliminating double taxation on foreign dividends. An arrangement or series of arrangements are regarded as not genuine if they are not carried out for valid economic reasons and do not reflect economic substance.

If the participation exemption regime does not apply, juridical double taxation is eliminated through an ordinary foreign tax credit, which is capped at the rate provided for under the CDT, if applicable. An underlying tax credit is also available to eliminate economic double taxation if the Portuguese company holds, directly or indirectly, at least 10% of the distributing subsidiary's share capital or voting rights for an uninterrupted period of one year prior to distribution (or this period is completed afterwards) and if the distributing subsidiary is not resident or domiciled in a blacklisted jurisdiction.

6.4 Use of Intangibles by Non-local Subsidiaries

The use by foreign subsidiaries of intangibles developed by Portuguese entities must be remunerated at arm's length. For the taxation of this income, please see **2.2 Special Incentives for Technology Investments** regarding the patent box rules.

All the CDTs entered into by Portugal provide for source taxation on royalty income (in line with the UN Model Convention). Accordingly, taxation may arise in the jurisdiction of the foreign subsidiaries, with a tax credit generally being available to eliminate double taxation.

6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules

Portuguese CFC rules closely follow the CFC provision included in the EU Anti-Tax Avoidance EU Directive.

Under the Portuguese CFC rules, the undistributed profit or income obtained by non-resident entities that are subject to a "considerably more favourable" tax regime is attributed and taxed at the level of the shareholders, either individuals or companies.

A foreign company is considered to be a CFC if all of the following requirements are met:

- the Portuguese shareholder holds 25% or more of the share capital, voting rights or rights to income or assets of a foreign sub-

sidiary, either directly, indirectly or through a nominee, an agent or any other form of fiduciary arrangement; and
- the foreign subsidiary is subject to a more favourable tax regime, which is considered to be the case when:
  (a) it is resident or domiciled in a blacklisted jurisdiction; or
  (b) the income tax effectively paid is lower than 50% of the tax that would be payable by the foreign subsidiary if it was resident in Portugal.

Nevertheless, the CIT Code provides for several safe harbours, according to which a company is not considered a CFC if:

- the foreign company qualifies as an "active foreign company", which is considered to be the case when less than 25% of its total income is comprised of:
  (a) royalties and other income derived from intellectual property rights, image rights and other similar rights;
  (b) dividends and income arising from the sale of shares;
  (c) income arising from financial leasing;
  (d) income arising from banking, insurance or any other financial activities carried on with related parties;
  (e) income obtained by invoicing entities deriving income from transactions with related parties that add little or no economic value; and
  (f) interest or other types of investment income; and
- the foreign company is resident in an EU or EEA member state that is bound to administrative co-operation on tax matters, there are valid economic reasons for its incorporation, and the company carries on an agricultural, commercial or industrial activity, including the provision of services, through its personnel, equipment, assets and premises.

Distributions of profits that have already been attributed and taxed at the level of the shareholder due to the application of CFC rules will be excluded from taxation in Portugal, without prejudice to any tax credits that may apply for taxes paid abroad.

6.6 Rules Related to the Substance of Non-local Affiliates

Other than the requirements set out under the CFC rules (see **6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules**), there are no specific provisions dealing with the substance of foreign entities. Foreign companies may also be considered tax resident by virtue of having their place of effective management in Portugal.

Nevertheless, the introduction of substance-based tests is expected if the proposal for the Unshell Directive is approved and enters into force.

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

Please see **2.7 Capital Gains Taxation**.

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions

Under the General Anti Abuse Rule (GAAR), the PTA may disregard an arrangement or a series of arrangements that have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, and are therefore not genuine or have been carried

out with abuse of legal forms, having regard to all relevant facts and circumstances. An arrangement or series of arrangements is considered not to be genuine when it is not carried out for valid economic reasons that reflect the economic substance.

As a result of the application of the GAAR, such arrangements or series of arrangements would be taxed in accordance with the rules applicable to transactions or acts that correspond to the substance or economic reality, without producing the tax advantages sought by the taxpayer with the structure implemented.

The Portuguese GAAR includes the uncommon feature of allowing the PTA to collect the tax due at the level of the entities obliged to levy withholding tax (paying entity) whenever that entity is or should be aware of the arrangement or series of arrangements that triggered the application of the GAAR.

In addition to the GAAR, there are several specific anti-abuse rules throughout the CIT Code dealing with tax-neutral reorganisations, tax losses trafficking or transactions involving blacklisted jurisdictions. These include aggravated tax rates, non-deductibility of expenses, denial of certain benefits, etc.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

There is no routine audit cycle, although audits need to be started within the statute of limitations (four years for CIT). The PTA adopts a yearly National Tax Inspections Plan, which sets out the criteria for tax inspections.

The PTA has also created the Large Taxpayers Unit, which monitors and supports large taxpayers with their compliance obligations. Entities qualifying as large taxpayers are generally subject to tax audits regularly. In 2022, the list of large taxpayers was broadened to include entities subject to the supervision of the Portuguese Securities Market Commission and non-resident entities without a Portuguese permanent establishment subject to the supervision of the Bank of Portugal.

9. BEPS

9.1 Recommended Changes

Portugal has implemented several provisions reflecting the BEPS recommendations and EU "BEPS-inspired" Directives, such as:

- anti-hybrid rules (Action 2);
- CFC rules (Action 3);
- interest barrier rules (Action 4);
- incorporation of the modified nexus approach to patent box regimes (Action 5);
- amendments to the permanent establishment provisions with the introduction of anti-fragmentation rules and the concept of "closely related enterprise", and the broadening of the concept of Agency permanent establishment (Action 7);
- alignment of Portuguese transfer pricing rules with the 2017 OECD Transfer Pricing Guidelines (Actions 8–10);
- disclosure of aggressive tax planning arrangements (Action 12 and Council Directive [EU] 2018/822 – DAC 6);
- country-by-country reporting – CbCR (Action 13 and Council Directive [EU] 2016/881); and
- signing the Multilateral Instrument (MLI), which has been in force since 1 June 2020.

9.2 Government Attitudes

In the context of its EU and OECD membership, Portugal has publicly supported and actively pursued the implementation of BEPS-related measures (see **9.1 Recommended Changes**).

Together with other EU member states, Portugal has been engaged in negotiations to approve Directives implementing the OECD's proposals under Pillar One and Pillar Two within the context of the EU.

Although no agreement has been reached regarding the implementation of Pillar One, on 12 December 2022 the Council of the EU reached consensus and approved the so-called Minimum Taxation Directive, on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union (Pillar Two). Portugal shall now incorporate the Directive into domestic law by 31 December 2023 for financial years starting on or after 31 December 2023, except for the undertaxed profits rules, which only apply for financial years starting on or after 31 December 2024.

9.3 Profile of International Tax

Portugal carried out a reform of its corporate taxation system in 2014, aimed at increasing the country's tax competitiveness and ensuring the inflow of foreign capital into the country.

Subsequently, in 2015, the taxation of collective investment undertakings was revamped to ensure taxation only at investor level, thus preventing double taxation and improving the competitiveness of the financial sector.

Since then, the changes introduced have related mostly to the implementation of BEPS recommendations, but these did not result in major change to Portugal's approach to international taxation.

Furthermore, the envisaged changes to the Portuguese international tax landscape refer to the transposition of the Minimum Taxation Directive and potentially the Unshell Directive.

9.4 Competitive Tax Policy Objective

Despite the introduction of a broad set of anti-abuse provisions (both BEPS and non-BEPS-related), as a capital importing country Portugal continues to seek to maintain a competitive tax policy that attracts international investment.

9.5 Features of the Competitive Tax System

In addition to the fairly recent amendments to the Portuguese corporate tax system outlined in the preceding sections, Portugal has several tax incentives, such as the Patent Box, SIFIDE and the Madeira Free Trade Zone.

Since Portugal is a member of the EU, it is subject to state aid restrictions. The application of the rules of the Madeira Free Trade Zone were recently held to be in breach of state aid provisions by the European Commission. Portugal challenged the EC's decision but the General Court of the EU rejected Portugal's claim in a ruling of 21 September 2022 (case T-95/21).

Portugal has appealed against the General Court's decision to the Court of Justice (case C-736/22 P), and a decision is expected within the next few months.

More than 30 companies have also filed claims against the EC's decision.

9.6 Proposals for Dealing With Hybrid Instruments

Portugal introduced anti-hybrid mismatch arrangements rules into Portuguese law through Law 24/2020 of 6 July 2020, which incorporated Council Directive (EU) 2016/1164 of 12 July 2016 (Anti-Tax Avoidance Directive – ATAD I) and Council Directive (EU) 2017/952 of 29 May 2017 (ATAD II) into Portuguese law. These rules closely follow the EU's approach to the issue.

9.7 Territorial Tax Regime

Portugal does not have a territorial tax system, as Portuguese tax resident entities are subject to CIT on their worldwide income.

Nevertheless, certain exceptions apply to such rule, such as the participation exemption regime applicable to foreign dividends and capital gains or the exemption for profits of foreign permanent establishments.

9.8 Controlled Foreign Corporation Proposals

Despite not having a territorial tax regime, Portugal has adopted CFC rules (see **6.5 Taxation of Income of Non-local Subsidiaries Under Controlled Foreign Corporation-Type Rules**).

9.9 Anti-avoidance Rules

Portugal adopted the GAAR in 1999, and the PTA has since applied it to recharacterise transactions in domestic (non-CDT) settings.

Despite being a public supporter of the BEPS recommendations, in the context of the MLI Portugal has merely opted for the application of minimum standard provisions, such as the inclusion of a Principal Purpose Test (PPT) in its CDTs.

According to publicly disclosed information, Portugal has elected for the inclusion of the PPT in its tax treaties because of the PTA's prior experience with the application of the GAAR. Despite the absence of case law on the matter, it is reasonable to expect that a similar standard will be applied by the PTA when applying the GAAR or the PPT.

9.10 Transfer Pricing Changes

In November 2021, Portugal updated its transfer pricing rules to reflect the amendments to the 2017 OECD Transfer Pricing Guidelines.

Since the PTA and Portuguese courts applied Portuguese rules in line with the OECD Transfer Pricing Guidelines, the amendments had limited practical impact.

Despite increasing litigation dealing with transfer pricing issues, the taxation of income arising from intellectual property has not given rise to additional controversy.

9.11 Transparency and Country-by-Country Reporting

Portugal has been at the forefront of transparency in international tax matters, first by promoting co-operation with foreign tax administrations (namely, through tax information exchange agreements), then by adopting mandatory disclosure rules on aggressive tax planning (initially in 2008 and then in 2021 to implement DAC 6) and finally by adopting CbCR rules.

The incorporation of Public CbCR rules pursuant to Council Directive 2021/2101, of 24 November 2021, into Portuguese law is currently pending.

There is no denying that transparency measures are an essential part of a healthy and thriving

international tax system, where ensuring a fair share of taxation became one of the end goals.

The thresholds applied to CbCR rules ensure that smaller groups will not be excessively burdened with compliance obligations and that the information to be made publicly available is adequately selected, providing the necessary data for scrutiny without creating the risk of leaks of classified information or know-how that could disrupt the business models of multinationals.

9.12 Taxation of Digital Economy Businesses

No rules dealing specifically with the taxation of digital economy businesses have been enacted or discussed at a Parliamentary level in Portugal.

Without prejudice, Portugal has adopted the following relevant measures:

- a yearly levy of 1% over the revenues of on-demand audio-visual services operators (the “Netflix Tax”);
- an advertising tax due for commercial advertising on platforms such as cinema, television, on-demand audio-visual and video-sharing platform services; and
- new VAT rules on distance selling and e-commerce.

Portugal is also expected to soon implement Council Directive 2021/514, of 22 March 2021 (DAC 7), which provides new due diligence and reporting requirements for digital platforms.

9.13 Digital Taxation

Please see **9.12 Taxation of Digital Economy Businesses** and comments regarding Pillar One in **9.2 Government Attitudes**.

9.14 Taxation of Offshore IP

Other than withholding tax being levied on outbound royalty payments at an aggravated 35% rate, there are no specific provisions dealing with the taxation of offshore intellectual property.

The deductibility of payments to entities resident or domiciled in blacklisted jurisdictions is subject to proof that the transaction indeed took place and was not abnormal in character.

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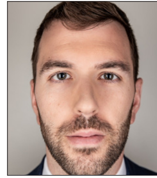

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