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Corporate Tax

Portugal
Law and Practice

Bruno Santiago, António Lobo Xavier,
António Pedro Braga and Francisco de Sousa da Câmara
Morais Leitão, Galvão Teles, Soares da Silva & Associados, SP, RL

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Law and Practice

Contributed by:
Bruno Santiago, António Lobo Xavier, António Pedro Braga and Francisco de Sousa da Câmara
Morais Leitão, Galvão Teles, Soares da Silva & Associados, SP, RL see p.18

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

1.1 Corporate Structures and Tax Treatment

Businesses generally adopt a corporate form, with the most commonly used being joint-stock companies (*Sociedades Anónimas,* or S.A.) and limited liability companies (*Sociedades por Quotas*, or Lda). Portuguese company law also establishes other forms, used less commonly. In general, joint-stock companies and limited liability companies are taxed according to similar rules, with both being treated for legal purposes (including tax) as separate entities, unless the tax transparency regime applies.

Joint-stock companies are subject to a minimum share capital of EUR50,000, represented by shares. The capital is divided into shares and the shareholders' liability is limited to the value of the shares subscribed.

Limited liability companies are formed by at least two shareholders (although limited liability companies with a single shareholder are also admitted). There is no minimum share capital required. Shareholders may be jointly responsible up to the amount of initial paid-in capital agreed in the articles of incorporation. Limited liability companies may be held by a single shareholder (*Sociedade Unipessoal por Quotas*), either upon formation or upon the redemption of the interest held in the company by other shareholders. In general, the same rules apply as for limited liability companies.

1.2 Transparent Entities

Partnerships – whether de facto or in the form of limited partnerships or limited liability partnerships – have not been recognised as such or established in either the company laws or the tax laws of Portugal. Accordingly, Portuguese tax law does not provide a comprehensive set of rules establishing how resident or non-resident partnerships/partners are taxed. Furthermore, no clear guidance is provided regarding how foreign partnerships should be respected as such or taxed as separate entities.

Notwithstanding, the Portuguese Corporate Income Tax Code (the "CIT Code") establishes a transparency regime that applies, inter alia, to certain family-owned companies dedicated to asset management, to certain companies that fall into the definition of Professional Services Firms, and to certain joint venture entities such as complementary groups of companies (*Agrupamento Complementar de Empresas*) and European Economic Interest Groups (*Agrupamento Europeu de Interesse Económico*).

Complementary groups of companies can be formed by a group of corporate entities/individuals, generally to facilitate collaboration between members in a specific business venture. A complementary group of companies has separate legal personality from its members. These entities are not subject to minimum registration capital, and members are jointly liable for the entity's debts.

European Economic Interest Groups are meant to facilitate or develop the economic activities of their members via a pooling of resources, activities or skills, and can be formed by legal entities governed by public or private law that have been formed in accordance with the laws of an EU country and have their registered office in the EU, as well as by individuals developing an industrial, commercial, craft or agricultural activity, or providing professional or other services in the EU. They must have at least two members from different EU countries. Each member of a European Economic Interest Group has unlimited joint and several liability for the entity's debts.

In addition, Portuguese Collective Investment Vehicles apply taxation schemes that privilege investor-level income taxation to fund-level income taxation (see **2.3 Other Special Incentives**).

1.3 Determining Residence of Incorporated Businesses

Portuguese tax residency of corporate entities is determined based on the location of the head office or place of effective management.

1.4 Tax Rates

The general CIT rate applicable on the Portuguese mainland is 21%, while the applicable tax rate in the Madeira Archipelago is 14.7% and in the Azores Archipelago it is 16.8%.

On the Portuguese mainland, entities qualifying as small and medium enterprises (SMEs) are subject to a 17% rate, which applies to the first EUR25,000 of taxable profit. The remaining profit is subject to the applicable general rates.

A state surtax applies to taxable profits exceeding EUR1.5 million, as follows:

- from EUR1.5 million up to EUR7.5 million – 3%;
- from EUR7.5 million up to EUR35 million – 5%; and
- profits exceeding EUR35 million – 9%.

Local surtax up to 1.5% of taxable profits is levied by municipalities.

Certain expenditures incurred by entities subject to CIT are separately subject to Autonomous Taxation (*Tributação Autónoma*) at varied rates, such as undocumented expenses, entertainment expenses and expenses incurred with vehicles.

Generally, taxable income derived from businesses operated directly by individuals is subject to personal income tax (PIT) and taxed as business income (Schedule B income) at progressive rates ranging from 14.5% to 48% and to a solidarity surcharge, also levied at progressive rates (2.5% to 5%), applicable to taxpayers with taxable income over EUR80,000. (See **3.2 Individual Rates and Corporate Rates**).

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

2.1 Calculation for Taxable Profits

Taxable profits are defined in the CIT Code as the sum of profits and losses (p&l) as well as the net variations in equity not reflected in p&l, as accrued and determined for accounting purposes, subject to the adjustments set forth in the CIT Code. These adjustments include:

- cancellation of the equity and the proportional consolidation methods;
- correction of fair value accruals/deductions;
- correction of amounts deducted as provisions and impairments in excess of deductible amounts as determined in the CIT Code;
- correction of amounts deducted with CIT, autonomous taxation and other taxes levied on profits paid by the taxpayer, penalties, fines, late payment and other compensatory interests paid and taxes levied on third parties that the taxpayer is not legally authorised to bear;
- deferred taxes;
- undocumented expenses;
- amounts paid or owed to entities subject to a privileged tax regime as defined in Portuguese tax laws;
- excessive depreciation and amortisation;
- bad debt deductions above the limits established in the CIT Code;
- unrealised capital gains and losses, as well as adjustments in connection with the capital gains rollover relief mechanism;
- gains or losses registered for accounting purposes with respect to derivative instruments;
- transfer pricing adjustments;
- interest deductibility limitations and excessive deduction carry-forwards;
- excessive deductions taken with respect to gifts and donations;
- tax regimes based on territoriality, including the deductions for dividends received and capital gains realised from the sale of certain securities as well as the application of the exemption method to foreign permanent establishments (PEs); and
- the patent box regime and tax depreciation for certain assets, including intangibles.

2.2 Special Incentives for Technology Investments

Patent Box

The Portuguese patent box grants a deduction corresponding to 50% of the income derived as consideration from the disposal or temporary use of certain industrial property rights (patents, industrial models and copyright on computer software), including income from the violation of such rights ("qualifying income"). Qualifying income is defined as the net positive balance between the revenues and gains derived in a given taxable year as consideration from the disposal or use of qualifying industrial property rights and the research and development (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.

This regime does not apply to any services supplied that are ancillary to a qualifying disposal or temporary use of industrial property.

2.3 Other Special Incentives

Portuguese tax law establishes several tax incentives aimed at promoting certain behaviour (eg, savings) or stimulating certain activities, industries and sectors. Notable sector-specific incentives include those granted to capital markets and to the financial sector in general, to real estate development and rehabilitation, to the shipping industry, wine production, sports and cultural activities, cinema, forestry management, patronage, philanthropic activities and the co-operative sector.

Pension Funds

Generally, pension funds established according to Portuguese law are exempt from Portuguese CIT and the municipal transfer tax applicable to the sale of real estate. This tax treatment may be extended to pension funds established under the law of another EU/EEA jurisdiction, provided the latter is bound by administrative co-operation or mutual assistance in taxation matters, when the following requirements are met:

- the pension fund should provide exclusively for retirement benefits in relation to ageing, incapacity, survival, pre-retirement or anticipated retirement, health benefits post-employment, and, when accessory to the referred benefits, death grants;
- the pension fund should be managed and supervised by an entity to which Directive 2003/41/EC of the European Parliament and of the Council applies;
- the pension fund should be the beneficial owner of the income; and

- if the income to be received by the pension fund is a profit distribution, the corresponding shareholdings must be held, uninterrupted, for at least one year.

Collective Investment Vehicles (CIVs)

Investment funds in securities, real estate investment funds, investment companies in securities and real estate investment companies established according to Portuguese law are technically subject to CIT on their taxable income; however, income typically derived by CIVs – including interest, dividends, capital gains and rents, as well as certain fees and commissions – is generally excluded from CIT. This exemption does not apply when the income is paid by an entity resident in a blacklisted jurisdiction. CIVs are exempt from municipal and state surcharges.

In addition, stamp duty applies on the net asset value of these funds on a quarterly base (at a rate of 0.0025% or 0.0125%, depending on the investment policy pursued).

Investors resident in Portugal are subject to tax on distributions, redemptions and the disposal of units or shares issued by CIVs (at different rates). Non-resident investors are exempt, except with respect to investments in real estate investment funds and companies, in which case a 10% rate applies.

Portuguese REITs and their shareholders have an income tax regime similar to real estate investment funds and companies, with the particularity that income from the sale of real estate is only excluded from tax when the immovable property has been held for renting purposes for at least three years.

Exemptions Applicable to Foreign Financial Entities

Interest payments made by resident financial institutions towards Portuguese resident financial institutions without a PE in Portugal are generally exempt from CIT (blacklisted entities as well as non-resident financial institutions substantially held by resident entities are excluded). Also, gains realised by non-resident financial institutions, in the context of swap transactions entered into with a resident financial entity, are also generally exempt from CIT (similar exclusions apply).

Exemption Applicable to Debt Instruments

Non-resident entities and individuals (except those that are resident in blacklisted Jurisdictions) are exempt from CIT and PIT otherwise due on interest and capital gains derived in connection with qualifying debt instruments that benefit from the regime set forth in Decree Law 193/2005.

Debt instruments qualifying for this regime include bonds issued by public and private sector entities, money market instruments (namely treasury bills and commercial paper), perpetual bonds, convertible bonds, other convertible securities, and tier 1 and tier 2 capital instruments, regardless of the currency of issue. Qualifying instruments must be integrated in a centralised system managed by a Portuguese resident entity or by an entity established in the EU/EEA that manages an international clearing system (in the latter case, provided that the state of establishment is bound to administrative co-operation for tax purposes equivalent to the rules in force in the EU).

The beneficiaries of this exemption include central banks and government agencies, international organisations recognised by Portugal, and entities resident in a country or jurisdiction that has entered into a double tax treaty or an exchange of information agreement with other entities that are not resident in a blacklisted jurisdiction.

Tonnage Tax and Seafarer Schemes

Following approval by the European Commission, two new schemes have been implemented:

- a special tax regime based on the amount of tonnage operated by ship-owners, applicable to eligible maritime transport activities, exempting the companies concerned from the general obligation to pay CIT irrespective of the companies' actual profits or loss (the "Tonnage Tax Scheme"); and
- a special tax and social contributions regime applicable to seafarers involved in eligible maritime transport activities, partially exempting them and their employers from the general obligation to pay income tax and social contributions (the "Seafarer Scheme").

2.4 Basic Rules on Loss Relief

For resident entities, there is no distinction between ordinary income/capital gains and ordinary losses/capital losses. The carry-forward of losses is available for five years, unless the entity is a certified SME, in which case the carry-forward of losses is available for 12 years. For each year, the deduction of tax losses is limited to 70% of the taxable profit. Carry-back is not allowed.

Portuguese law establishes a general anti-loss trafficking rule, under which, loss carry-forward is not allowed if more than 50% of the entity's ownership (share capital or voting rights) has changed between the taxable year in which such losses were generated and the end of the taxable year in which the deduction is claimed. However, several exceptions apply to the general rule (eg, when the ownership is converted from direct into indirect or from indirect into direct, and when an interest is exchanged between entities whose share capital or voting rights are held directly or indirectly by a common entity).

When no exception applies, the Minister of Finance may approve the transfer of losses to the extent that a motion is filed with the tax authorities and it is considered that there is a recognised economic interest in authorising such transfer.

In the case of non-resident entities, no carry-forward of losses is available for business income unless such entities have a PE in Portugal. Non-residents that derive Portuguese-source capital gains and do not have a PE in Portuguese territory to which such gains are attributable are subject to tax on the balance of Portuguese-source capital gains and losses. In the case of securities, exemptions may apply (see **7. Anti-avoidance** for more details).

2.5 Imposed Limits on Deduction of Interest

In general, business expenses, including interest, are deductible for tax purposes to the extent they are necessary to obtain or guarantee income subject to CIT. There are, however, certain limitations that are applicable to interest expenses deductibility.

Interest Barrier Rule

Net interest expenses may be deducted up to the greater of the following limits:

- EUR1 million; or
- 30% of EBITDA as determined by accounting rules and corrected for tax purposes.

It is possible to carry forward excess interest deductions and unutilised limits for five taxable years. Excess interest deductions and unutilised carry-forwards are applied on a first-in, first-out basis, after the current year's interest is deducted. Rules similar to the anti-loss trafficking rules detailed above also apply to excess interest deductions and unutilised limits.

Companies taxable under the Special Regime of Group Taxation (*Regime Especial de Tributação dos Grupos de Sociedades*, or RETGS) may elect to apply these rules on a group basis. Likewise, certain rules limit the deductibility of interest as well as the application of excess limits pertaining to pre-grouping or post-grouping taxable years.

Transfer Pricing and Shareholder Loans

In addition to the above, transfer pricing rules may limit the deductibility of interest in the case of debt arrangements entered into between related parties, as defined for tax purposes, to the extent such interest is not established according to the arm's-length principle.

Unless transfer pricing rules apply, interest and other forms of compensation agreed under financial arrangements, qualified as shareholder loans (*suprimentos*), cannot be deducted in excess of the rate established in a ministerial decree issued by the Minister of Finance.

2.6 Basic Rules on Consolidated Tax Grouping

The RETGS is not a consolidation regime, but rather an optional tax regime under which the "Dominant Company" of a "Group of Companies" may elect to aggregate the taxable profits and losses of any other company pertaining to the same group of companies ("Member Companies").

Under the RETGS, a Group of Companies exists when a company (the Dominant Company) directly or indirectly holds 75% of the share capital of another company or companies (the Member Companies), as long as such interest provides the Dominant Company with the majority of the voting rights in each of the Member Companies.

An election to apply the RETGS can only be filed when certain conditions applicable to the Dominant Company and to the Member Companies are cumulatively fulfilled.

The RETGS ceases to apply when any of the mandatory requirements concerning the Dominant Company are no longer fulfilled, or when the taxable profits of any of the entities forming the Group of Companies are determined according to an indirect assessment. When a Dominant Company becomes controlled by another Portuguese company that fulfils the requirement to be considered a Dominant Company (other than the requirement with respect to losses during the three previous tax periods) during the application of the RETGS, the latter may elect to continue to apply the RETGS.

Specific and strict rules apply to the carry-forward of losses during the application of the RETGS, including in cases where a non-recognition transaction occurred. Also, pre and post-RETGS loss carry-forward is limited.

2.7 Capital Gains Taxation

In general, capital gains are considered taxable profits and are taxed at the general CIT rate. Capital losses may be deducted if the general deductibility rules are fulfilled, but not to the extent such losses correspond to profits or reserves distributed in previous years or capital gains realised on the disposal of shares that benefited from the participation exemption or from the foreign (indirect) tax credit.

The participation exemption regime exempts capital gains and losses realised by Portuguese-resident companies with share transfers, provided that the following requirements are met.

- The company disposing of the interest must hold – directly and/or indirectly – at least 10% of the share capital or voting rights of an entity.
- Such interest must be held for a minimum period of one year.
- The entity disposing of the interest must not be taxed under the tax transparency rules.
- The company whose shares are disposed of must either:
  (a) be liable to CIT in Portugal without being exempt;
  (b) if resident in the EU, be liable to a tax mentioned in Article 2 of Directive 2011/96/UE without benefiting from an exemption; or
  (c) if resident outside the EU, be liable to a tax that is similar to the CIT, where the applicable rate is not below 60% of the Portuguese CIT rate (this condition may be waived under certain circumstances).
- The entity whose shares are being disposed of should not be a resident of a blacklisted jurisdiction.
- No more than 50% of the value of the subsidiary's total assets is comprised of real estate located in Portugal, unless such properties are used in connection with an agricultural, industrial or commercial activity (other than a real estate buy and sell activity).

Additionally, a rollover relief mechanism may be used to exclude 50% of the positive balance of capital gains and losses realised on the sale of tangible fixed assets, intangible assets and non-consumable biological assets, held for at least one year, from taxable income, to the extent the realisation value of such assets is wholly or partially reinvested in the acquisition, production or construction of similar assets during a four-year reinvestment period that corresponds to the two years before and the two years after the taxable period in which the realisation occurs. The law establishes specific rules to be observed, including regarding the type of assets qualifying for this regime.

When the reinvestment is not wholly or fully made until the end of the reinvestment period, the income that was not previously recognised for tax purposes must be subject to taxation in that period, increased by 15%.

Non-resident taxpayers who do not have a Portuguese-situs PE may be subject to Portuguese-source capital gain taxation on the disposal of the following assets:

- Portuguese-situs real estate;
- the disposal of shares in real estate-rich companies (whether or not such companies are resident for tax purposes in Portugal); or
- the disposal of shares in Portuguese companies.

There is an exemption that applies to non-resident entities or individuals deriving Portuguese-source capital gains from the disposal of shares and other securities issued by Portuguese entities, but this exemption does not apply in the following cases.

- To non-resident entities domiciled in a blacklisted jurisdiction.
- To non-resident entities that are directly or indirectly held, at more than 25%, by resident entities, except when:
  (a) the non-resident entity is liable to a tax mentioned in Article 2 of Directive 2011/96/UE without benefiting from an exemption, or, if resident outside the EU, to a tax that is similar to the CIT, where the applicable rate is not below 60% of the Portuguese CIT rate;
  (b) the non-resident disposing of the interest has held directly and/or indirectly at least 10% of the share capital or voting rights of the Portuguese issuer for a minimum period of one year prior to the disposal; and
  (c) the non-resident entity is not part of an artificial arrangement, or a series of artificial arrangements, put in place with the main purpose of obtaining a tax advantage.
- When more than 50% of the total assets of the Portuguese entity whose shares are being disposed of consists of immovable property located in Portugal.
- When the entity whose shares are disposed of actively manages or passively holds control in other Portuguese resident companies, whose assets, in turn, are made up by more than 50% of immovable property located in Portugal.

2.8 Other Taxes Payable by an Incorporated Business

Other taxes may apply to specific transactions, namely:

- value added tax (VAT), generally levied on the supply of goods and services;
- stamp duty, which may apply to contracts, acts, documents, titles, books and other items occurring or deemed to be occurring within Portuguese territory listed in the General Table that are not subject to, or exempt from, VAT, such as the acquisition of real estate, the use of credit and guarantees; and
- property transfer tax (IMT), which may be levied on the transfer of real estate located in Portugal.

2.9 Incorporated Businesses and Notable Taxes

Other than the taxes mentioned in **2.8 Other Taxes Payable by an Incorporated Business**, a company owning real estate in Portugal is generally subject to property tax (IMI), levied at a rate ranging from 0.3% to 0.45% (urban properties) of the tax

registration value. An addition to the property tax, called AIMI, may also apply.

Also, industry-specific levies may apply to companies operating in certain sectors.

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

3.1 Closely Held Local Businesses

Generally, most closely held local businesses operate in corporate form.

3.2 Individual Rates and Corporate Rates

The CIT Code comprises a tax transparency regime that applies to the following entities in specific situations:

- companies incorporated under the form of civil companies with commercial capacity;
- "professional services firms" ("*Sociedade de Profissionais*"); and
- companies established for the passive administration of certain assets, values or goods held for the fruition of their shareholders.

A "professional services firm" is defined as a company in which all the shareholders undertake the same type of professional activities listed in a ministerial order – doctors, dentists, lawyers, etc – and more than 75% of the income is derived from at least one qualifying professional activity, as long as its shares are held by not more than five shareholders for more than 183 days per tax year, with none of them being a public company, and at least 75% of the share capital is held by professionals who carry out such activities, totally or partially through the company.

The taxable profits are computed at a corporate level but are attributable to the shareholders and taxed as business (Schedule B) income. If the shareholder receives payments on account of future dividends during a given tax period, and such payments are in excess of the income attributed via the tax transparency regime, then the total amount of such payments should be taxed as self-employment/business income (*Categoria B*) for PIT purposes.

3.3 Accumulating Earnings for Investment Purposes

If a closely held corporation is domiciled in a blacklisted jurisdiction, it may be considered a controlled foreign company (CFC), in which case, anti-deferral rules could apply. In this case, the CFC profits or income may be attributable to the individuals holding an interest in the CFC, in the proportion of such interest. Income so attributed is characterised as business (Schedule B) income if the interest is used in a business activity, or as investment (Schedule E) income in all other cases.

If the tax transparency regime applies, the taxable profits of the tax transparent entity are directly attributable to the shareholder, and are taxed as business income for PIT purposes. If the shareholder receives payments on account of future dividends during a given tax period, and such payments are in excess of the income attributed via the tax transparency regime, then the total amount of such payments should be taxed as self-employment/business income (*Categoria B*) for PIT purposes.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Capital gains realised on the sale of shares by resident individuals are taxed at a special 28% rate (Schedule G income), unless the taxpayer chooses to include this income and submit it to the progressive rate structure and the solidarity surcharge, or unless it is shares from a non-listed micro or small-sized company that are taxed at the effective rate of 14%.

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

The rules that apply to the taxation of dividends and capital gains derived by individuals from publicly traded corporations do not differ from those applicable to income derived from privately traded corporations.

Dividends received by resident individuals are taxed at a 28% flat rate unless the taxpayer elects to include this income and apply the general progressive rate structure. In this case, when dividends are distributed by Portuguese-resident companies or EU/EEA companies (in the latter case, provided that the state of establishment of the distributing company is bound to administrative co-operation for tax purposes equivalent to the rules in force in the EU) and the same requirements established in the Parent-Subsidiary Directive are fulfilled, the taxpayer will be able to include an amount corresponding to 50% of such dividend.

Capital gains realised on the sale of shares by resident individuals are generally taxed at a special 28% rate (Schedule G), unless the taxpayer chooses to include this income and submit it to the progressive rate structure and the solidarity surcharge.

Contributed by: *Bruno Santiago, António Lobo Xavier, António Pedro Braga and Francisco de Sousa da Câmara*
Morais Leitão, Galvão Teles, Soares da Silva & Associados, SP, RL

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

In general, interest, dividends and royalties paid by Portuguese resident companies to non-resident companies are subject to withholding tax at the rate of 25%.

Dividends, interest and royalties, among other forms of capital income, paid or made available to accounts held by one or more holders on behalf of unidentified third parties, or to entities deemed to be tax resident in blacklisted jurisdictions, should be subject to withholding tax at the rate of 35%.

Withholding tax on distributions of dividends may not take place if the Portuguese participation exemption regime is applied.

Dividends distributed by resident entities to non-resident entities should be exempt from CIT provided that:

- the beneficiary of the income is resident in another EU country, an EEA country that submits to administrative co-operation in a similar manner as between EU countries, or a country with which Portugal has executed a double taxation treaty (DTT) that is in force and provides for the possibility of the exchange of information;
- the beneficiary of the income holds, directly and/or indirectly, at least 10% of the share capital or voting rights of the distributing company;
- such participation has been held uninterrupted during the 12 months prior to the distribution of the dividends; and
- the beneficiary of the income is subject to, and not exempt from, any of the income taxes referred to in the EU Parent-Subsidiary Directive, or is subject to, and not exempt from, a tax of a similar nature with a rate that cannot be lower than 60% of the Portuguese CIT rate (ie, currently such tax rate cannot be lower than 12.6%).

In order to benefit from this tax exemption, the beneficiary of the income must fulfil some formal obligations.

This exemption regime also applies to dividends distributed by a resident company to a PE located in other EU or EEA countries of an entity that meets the mentioned requirements.

On the other hand, these tax exemptions are not applicable if there is an arrangement – or several arrangements that are not genuine – whose primary purpose, or one of those, is to obtain a tax advantage that defeats the object and purpose of eliminating the double taxation of dividends. This regime should also not apply if the Portuguese distributing company has not complied with the declarative obligations imposed by the Portuguese legal regime of the beneficial owner central registry.

Regarding interest and royalties income, the withholding tax may be eliminated by the tax framework established by the EU Interest and Royalties Directive (I&RD), provided that the following requirements are met:

- the entity that pays and the entity that benefits from the relevant income should be subject to and not exempt from corporate tax, and incorporated under one of the legal forms listed in the annex of the I&RD;
- both entities should be deemed EU residents for DTT purposes;
- a direct 25% shareholding should be held by one of the companies in the share capital of the other, or a third company should 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 payment should be its effective beneficiary.

The payment of interest and royalties to a company or a PE resident in Switzerland may also benefit from this exemption regime, provided that the aforementioned requirements are fulfilled.

The application of this tax exemption regime also depends on the fulfilment of some formal requirements.

The beneficiary may also apply for the later reimbursement of the withheld tax within the next two years following the respective payment.

This tax exemption regime on interest and royalties payments should not be applicable to the part of the income that does not comply with the arm's-length principle.

Interest from debt securities issued by Portuguese companies and made available to non-residents may also be exempt from withholding tax under Decree-Law No 193/2005 of November 7th.

4.2 Primary Tax Treaty Countries

Portugal has so far executed 80 DTTs, 78 of which are in force. The last DTT to enter into force was with Angola. Finland has denounced its DTT with Portugal, so that a DTT has not been available since 1 January 2019.

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

Over the last few years, the Portuguese tax authorities (PTA) have increased their focus on cross-border tax matters, aiming to tackle treaty shopping practices, following the best international practices on the matter.

The last reports on activities developed for the combating of fraud and tax evasion that were released by the PTA highlighted the efforts to tackle cross-border abusive practices and an increase in the use of the international mechanisms available for the exchange of tax information.

In accordance with such reports, the PTA also intend to increase their control over cross-border transactions made between related parties, as well as over entities developing their business activities by means of new business models based on information technologies. One way to mitigate the risks arising from related-party transactions may be to execute an advance pricing agreement (APA).

4.4 Transfer Pricing Issues

The most common transfer pricing issues that foreign investors usually have to deal with regarding local corporations are related to the terms and conditions established between the related parties regarding interest on financing, as well as on the amount of management fees and royalties.

The Portuguese transfer pricing regime was amended in 2019 in order to expressly establish that the transfer pricing rules are applicable to corporate restructurings whenever they include the transfer of tangible or intangible assets, rights on intangible assets or compensation payments for losses.

4.5 Related-Party Limited Risk Distribution Arrangements

In general, Portugal follows the OECD standards on transfer pricing issues; therefore, the PTA are legally entitled to challenge the agreements established by related parties with reference to limited risk distribution for the sale of goods or the rendering of services. The control of such arrangements is common for international corporate groups. These arrangements may also be covered by an APA.

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

Considering that Portugal tends to follow the OECD standards on transfer pricing matters, there are no particular differences to emphasise.

4.7 International Transfer Pricing Disputes

From a Portuguese tax standpoint, it is not common to settle transfer pricing disputes through DTTs and mutual agreement procedures (MAPs). Nevertheless, there are some cases duly documented in OECD statistics.

According to such statistics, at the end of 2019, Portugal had approximately 70 ongoing MAPs. Approximately nine of these cases started before 1 January 2016, while the remaining started after such date. Moreover, the number of ongoing MAPs related to transfer pricing cases increased to approximately 39.

The average time needed to close MAPs related to transfer pricing issues and started before 1 January 2016 was approximately 83.5 months. As regards the transfer pricing MAPs started after the previously mentioned date, the "start to end" timeframe was approximately 29.5 months.

On the other hand, the outcome of the MAPs was essentially the following:

- denied MAP access – 8%;
- agreement fully eliminating double taxation – 50%;
- unilateral relief granted – 17%; and
- withdrawn by taxpayer – 25%.

Furthermore, in December 2017, the PTA published Guidelines for the use of the International MAP Procedures in accordance with the Double Tax Treaties entered into by Portugal, and with the Arbitration Convention – Convention 90/436/EEC, of 23 July 1990, on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims Are Settled

As a rule, when the PTA execute a transfer pricing adjustment for one related party in a transaction, a correlative adjustment may be made by the other related party involved in such transaction.

Additionally, several DTTs entered into by Portugal provide a mechanism under which transfer pricing adjustments made by the tax authorities in one state may lead to a correlative adjustment in the other party's state of residence for the avoidance of potential double taxation.

Finally, where a transfer pricing adjustment leads to additional tax liability towards the PTA, the relevant company should be

bound to pay compensatory interest to said authorities at a rate of 4% per year. Specific penalties may also apply.

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

As a rule, local branches and local subsidiaries of non-local corporations are taxed on the same basis. However, the following aspects in the tax regime applicable to a local branch of a foreign corporation should be considered:

- general administrative and management expenditures made by the head office of the non-local corporation for its local branch may be allocated to the latter;
- income paid by the local branch to its head office should be exempt from withholding tax; and
- some limits on the deductibility of some expenditures charged by the head office to the local branch may apply, namely regarding royalties and interest.

5.3 Capital Gains of Non-residents

As a rule, capital gains made by non-resident entities from the transfer of stock in local corporations are subject to tax at the rate of 25%, but may be exempt from taxation in Portugal provided that the following apply.

- More than 25% of the non-resident company is not held, directly or indirectly, by Portuguese tax residents, unless the following requirements are cumulatively met:
  (a) the non-resident company is resident in an EU country, in an EEA country that submits to administrative co-operation on tax matters with Portugal in a similar manner as between EU countries, or in a country with which Portugal has executed a DTT that is in force and provides for the exchange of information on tax matters;
  (b) the beneficial owner is subject to, and not exempt from, a tax identified in Article 2 of Directive 2011/96/UE of 30 November 2011, or subject to, and not exempt from, a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT rate;
  (c) the beneficial owner uninterruptedly holds, directly or indirectly, at least 10% of the share capital or voting rights of the transferred entity for at least one year; and
  (d) the beneficial owner is not part of an arrangement or several arrangements with an artificial nature that have been put in place with the main purpose of gaining a tax advantage.
- The non-resident entity is not domiciled in a blacklisted jurisdiction.
- The capital gains obtained by the non-resident are not related to the transfer of shares of a resident company whose assets are composed, directly or indirectly, more than 50% of real estate property located in Portugal.

Some DTTs entered into by Portugal also establish a waiver of taxation regarding capital gains obtained from the sale of a local company, provided that such capital gains are not allocated to a PE located in the Portuguese territory.

Assuming that the beneficiary of the income is not a Portuguese tax resident, no taxation should be triggered in Portugal on capital gains arising from the transfer of non-local holding companies unless the assets of such non-local holding companies are essentially constituted by rights over real estate properties located in Portugal.

5.4 Change of Control Provisions

The most relevant tax issues that may be triggered by a change of control are the following:

- the tax losses registered by the local company may be lost in the event of a change of ownership of 50% of its share capital or the majority of its voting rights;
- if the local company is included in the tax perimeter of a corporate tax group, such group may register changes in its perimeter and, in a worst-case scenario, may cease to exist;
- the possibility of deducting interest that was not deducted in previous financial years as a result of the application of the limits established by the interest barrier rules may also be lost in the event of a change of ownership of 50% of its share capital or the majority of its voting rights; and
- some tax benefits, particularly tax benefits of a contractual nature, may be lost.

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

The rules that apply to the determination and assessment of the respective taxable income are the same for local-owned and foreign-owned affiliates, including the transfer pricing rules that apply to transactions made between related parties.

5.6 Deductions for Payments by Local Affiliates

As a rule, payments regarding management and administrative expenditures made to non-local affiliates are deductible for tax purposes, assuming that they are deemed necessary for the business of the local affiliate. Formal requirements regarding the documentary support of such expenses should be observed.

Finally, the terms and conditions related to the rendering of said services and the payment of the relevant fees are subject to the Portuguese transfer pricing rules and should be made according to the arm's-length principles. Otherwise, the PTA may deny the tax deductibility of such expenses.

5.7 Constraints on Related-Party Borrowing

As a rule, there are no specific constraints, but such transactions should be made in accordance with the transfer pricing rules and the arm's-length principle, or they risk being challenged by the PTA.

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

6.1 Foreign Income of Local Corporations

The CIT Code subjects resident companies to tax on all their income, regardless of the country of source. On the other hand, all deductible expenses are also taken into account to determine the taxable income of the local company, independently from the location where such expense is incurred.

Furthermore, the CIT Code expressly provides different methods to eliminate double taxation, namely tax credit and tax exemption methods.

Regarding tax credit methods, a credit deduction for international double taxation is available for situations in which income generated abroad is included in the taxable income.

The tax credit should correspond to the income tax paid in the foreign country, or to the amount of CIT assessed before the deduction, corresponding to the net income that may be taxed in the foreign country, whichever is lower.

Additionally, if a DTT applies, the tax credit should not exceed the tax that should have been borne abroad pursuant to the terms established by the DTT.

For the exemption method, the participation exemption regime should be highlighted, as well as a special regime applicable to foreign PEs that allows the tax exemption of the income generated by them in order to mitigate distinctions between foreign subsidiaries and foreign PEs.

This regime is optional and, if exercised, has to include all the PEs located in the same territory, and should remain in force for a minimum period of three years. Additionally, the following requirements should be met:

- the PE should be subject to, and not exempt from any of, the income taxes identified in the Parent-Subsidiary Directive, or subject to, and not exempt from, a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT;
- the PE should not be considered resident in a blacklisted jurisdiction; and
- the amount of tax effectively paid should not be less than 50% of the amount of tax that would be due under the terms of the CIT Code.

This last requirement may not apply if the following types of income obtained by the relevant entity do not exceed 25% of its global amount of income:

- royalties and other income regarding intellectual property rights, image rights and other similar rights;
- dividends and income arising from the sale of shares;
- income arising from financial leasing;
- income arising from banking business activities, even when not obtained by a credit institution, as well as from insurance activity or any other financial activities entered into with related entities;
- income obtained by invoicing entities whose income arises from transactions made with related entities; and
- interest and other types of capital income.

Moreover, the Portuguese company cannot choose to exclude the profits assessed by the foreign PE from its taxable income, up to the amount of tax losses assessed by such PE as have concurred to determine the Portuguese company's taxable income in the previous five fiscal years, or the previous 12 fiscal years for small and medium companies.

The Portuguese company also cannot choose to include the losses assessed by the foreign PE in its taxable income, up to the amount of profits that such PE has assessed that have not concurred to determine the Portuguese company's taxable income in the previous five fiscal years, or the previous 12 fiscal years for small and medium companies.

6.2 Non-deductible Local Expenses

The optional regime mentioned above with reference to foreign PEs of Portuguese companies should be considered in light of local expenses. Provided that the same regime applies, the expenses made by the foreign PE are not deductible to determine the taxable income of the Portuguese company.

6.3 Taxation on Dividends from Foreign Subsidiaries

As a rule, dividends from foreign subsidiaries are considered taxable income for the resident shareholder and subject to taxation at the rates stated in the Portuguese CIT Code. However, tax relief or even a tax exemption may be obtained in accordance with the applicable DTT.

In order to avoid economic double taxation, the Portuguese CIT Code sets out a participation exemption regime, pursuant to

which, inbound dividends may be exempt from CIT, provided that the following requirements are cumulatively met.

- The Portuguese company holds, directly or directly and indirectly, at least 10% of the share capital or voting rights of the distributing company.
- The shares have been held uninterruptedly for a 12-month period prior to the distribution of dividends (or, if held for a minor period, they are kept until the completion of such period).
- The Portuguese company is not subject to tax transparency.
- The distributing company is subject to, and not exempt from, CIT or any of the income taxes identified in the Parent-Subsidiary Directive, or a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT. This requirement may not be applied if the tax effectively paid was not less than 50% of what would have been paid if the distributing company was resident in Portugal.
- The distributing company is not deemed to be a tax resident in a blacklisted jurisdiction.

This tax exemption is subject to a specific anti-abuse clause, pursuant to which, it should not be applicable if there is an arrangement or several arrangements, not deemed as genuine, that have been executed with the main purpose of obtaining a tax advantage defeating the object and purpose of eliminating the double taxation of dividends, taking into consideration all the relevant facts and circumstances.

For this purpose, an arrangement, or a set of arrangements, should be considered as non-genuine when it is not executed for valid economic reasons and does not reflect economic substance.

6.4 Use of Intangibles by Non-local Subsidiaries

Please see **2.2 Special Incentives for Technology Investments** regarding the patent box regime.

6.5 Taxation of Income of Non-local Subsidiaries Under CFC-Type Rules

The Portuguese CFC rules contained in the CIT Code closely follow the CFC regimes that have been adopted by several other EU countries.

According to the Portuguese CFC rules, the income generated by a CFC should be subject to taxation regardless of any dividends distribution, provided that some requirements regarding the percentage of shareholding, the location of the foreign entity in a tax haven territory and the evaluation of profit generated by the respective economic activity are met.

As regards the shareholding percentages, the resident shareholders – whether individuals or companies – should hold at least 25% of the shares, voting rights, profit rights or assets of the relevant non-resident entity, either directly, indirectly or by means of a fiduciary or an interposing agent.

With reference to the location criteria, a controlled company is an entity domiciled in a blacklisted jurisdiction, or an entity that is subject to an amount of tax on income that is lower than 50% of the amount of tax that would be due in taxation under the rules set forth by the CIT Code.

Finally, regarding the business activity requirement, CFC rules may not apply if the following types of income obtained by the relevant entity do not exceed 25% of its global amount of income:

- royalties and other income regarding intellectual property rights, image rights and other similar rights;
- dividends and income arising from the sale of shares;
- income arising from financial leasing;
- income arising from banking business activities, even when not obtained by a credit institution, as well as from insurance activity or any other financial activities entered into with related entities;
- income obtained by invoicing entities whose income arises from transactions made with related entities; and
- interest and other types of capital income.

These CFC rules do not apply when the foreign entity is resident in another member state of the EU/EEA (in the latter case, provided that the state of establishment is bound to administrative co-operation for tax purposes equivalent to the rules in force in the EU), and the resident company shows that the setting up and activity of such foreign entity is grounded in valid economic reasons and that the entity develops a business activity that involves employees, assets and business facilities.

6.6 Rules Related to the Substance of Non-local Affiliates

With the exception of the mentioned CFC rules, as well as the substance rules provided by the participation exemption regime and the exemption regime applicable to capital gains made by foreign entities, there are no specific rules regarding the substance of non-local affiliates. Nevertheless, the Portuguese CIT Code sets forth that a company may be considered a tax resident if its effective management takes place in Portugal.

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

Please see **2.7 Capital Gains Taxation**. The gains should benefit from the participation exemption regime, provided that the following requirements are cumulatively met.

- The local corporation holds, directly and/or indirectly, at least 10% of the share capital or voting rights of the transferred company.
- The local corporation is not subject to tax transparency.
- The transferred shares were held uninterrupted for a 12-month period prior to the transfer.
- The non-local affiliate is subject to and not exempt from CIT, any of the income taxes identified in the Parent-Subsidiary Directive, or a tax of a similar nature with a rate not lower than 60% of the Portuguese CIT. This requirement may not be applied if the income tax effectively paid was not less than 50% of what would have been paid if the distributing company was resident in Portugal.
- The non-local affiliate is not deemed to be a tax resident in a blacklisted jurisdiction.

The requirement of the non-local affiliate being subject to an income tax with a rate not lower than 60% of the Portuguese CIT may not apply if the following types of income obtained by the relevant entity do not exceed 25% of its global amount of income:

- royalties and other income regarding intellectual property rights, image rights and other similar rights;
- dividends and income arising from the sale of shares;
- income arising from financial leasing;
- income arising from banking business activities, even when not obtained by a credit institution, as well as from insurance activity or any other financial activities entered into with related entities;
- income obtained by invoicing entities whose income arises from transactions made with related entities; and
- interest and other types of capital income.

This exemption does not apply if the non-local affiliate has real estate in Portugal valuing more than 50% of its assets, unless such real estate is allocated to an agricultural, industrial or commercial activity (other than a real estate buy and sell activity) or was acquired before 1 January 2014.

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions

There is a general anti-abuse rule (GAAR) under which the PTA can disqualify, for tax purposes, the typical effect of an arrangement or a series of arrangements that, having been put into place for the main purpose of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are executed with an abuse of legal forms or are not genuine, having regard to all relevant facts and circumstances.

Where an arrangement or a series thereof is disqualified for tax purposes, the tax liability shall be calculated in accordance with the tax rules applicable to the arrangements corresponding to the underlying substance or economic reality.

For these purposes, an arrangement or a series of arrangements shall be regarded as non-genuine to the extent that it is not put into place for valid commercial reasons that reflect economic reality.

Whenever the GAAR applies, the compensatory interest rate levied by the tax authorities will be increased to 15%.

8. Audit Cycles

8.1 Regular Routine Audit Cycle

While there is no routine audit cycle that applies to all companies, the PTA prepare a National Tax and Customs Inspections Plan on a yearly basis. This plan establishes the programmes and criteria for tax inspections, directing the audit activities of the tax authorities.

Furthermore, the PTA created a Large Taxpayers Unit, which supports compliance and constantly monitors the tax activity of large taxpayers.

9. BEPS

9.1 Recommended Changes

Portugal has already implemented several BEPS measures, such as the ones that follow:

- non-application of the participation exemption regime if the dividends received correspond to costs that are deductible for tax purposes at the level of the distributing company or if the structure has a lack of economic substance (Action 2);
- neutralising the effects of hybrid mismatch arrangements (Action 2);
- CFC rules (Action 3);
- the introduction of interest barrier rules (Action 4);
- amendment of the patent box regime in order to align it with the "modified nexus approach" (Action 5);
- disclosure of aggressive tax planning practices (Action 13); and

• country-by-country (CbC) reporting (Action 13).

Portugal is also a signatory of the Multilateral Instrument (MLI).

Some of the actions mentioned above are the result of the implementation of EU directives addressing some of the key factors identified by the BEPS Action Plan.

Also, CbC reporting was introduced in 2016, whereby multinational groups should submit country-specific statements disclosing detailed financial and tax information to the PTA, provided certain requirements are met.

9.2 Government Attitudes

As an EU and OECD member, Portugal is committed to the implementation of the BEPS Action Plan. Several BEPS measures have already been implemented, whether by unilateral decision or by implementation of EU directives dealing with the same tax challenges that are identified in several BEPS actions. Thus, for the next few years, the BEPS Action Plan should not give rise to any relevant tax reform in Portugal.

However, there are some specific tax issues that led to slight amendments during 2019. For instance, Law No 32/2019, of May 3rd, was approved, introducing amendments to the CFC rules, interest barrier rules, exit tax and the GAAR in order to conclude the transposition into the Portuguese tax system of the Anti-Tax Avoidance Directive (ATAD). Also, Law No 119/2019, of September 18th, introduced amendments to the transfer pricing rules.

9.3 Profile of International Tax

Portugal enacted major corporate tax reform in 2014 aimed at increasing competitiveness, allowing stability and attracting investment in order to relaunch the Portuguese economy.

Such corporate tax reform, along with other changes in the economic environment, contributed to bringing international investment and, consequently, international taxation to a high level of attention in Portugal.

Moreover, in order to protect the legal framework arising from said tax reform and assure stability for investors, the solutions adopted have already taken into account the international trends in corporate taxation, namely regarding BEPS Action Plan discussion.

Considering the high level of implementation that the BEPS Action Plan already has in the Portuguese corporate tax framework as a result of the solutions established by said tax reform, no relevant developments on these matters are expected in the near future.

9.4 Competitive Tax Policy Objective

Please see the previous sections in relation to this matter.

9.5 Features of the Competitive Tax System

Reference should be made to the relevant preceding sections.

9.6 Proposals for Dealing with Hybrid Instruments

As mentioned above, as an EU country, Portugal is subject to the two EU anti-tax avoidance directives, ATAD and ATAD 2, which establish anti-hybrid rules aimed to cover hybrid mismatches. Anti-hybrid rules established in ATAD 2 were implemented by Law 24/2020, of July 6th.

9.7 Territorial Tax Regime

As a rule, Portuguese tax-resident entities and individuals are subject to income taxation based on their worldwide income. However, new territorial features were introduced by the CIT reform in 2014, including a participation exemption applicable to capital gains and losses, an exemption applicable to gains derived upon the liquidation of non-resident entities, and an elective regime under which profits attributable to foreign PEs may be exempt from CIT in Portugal.

Following the trend established in Germany and Spain, in 2012 Portugal introduced a BEPS-compliant restructuring of its interest deductibility limitations, including a so-called EBITDA rule, which is in line with BEPS Action 4.

9.8 CFC Proposals

Portugal does not have a territorial tax regime. A sweeper CFC rule would likely simplify the CFC rules in general (including the Portuguese), but would likely struggle with both constitutional and EU-level opposition to the extent it could no longer resemble an anti-avoidance mechanism targeted at countering unsubstantiated deferral practices. In addition, such a rule could also disproportionately affect legitimate business decisions, thus creating potential economic distortion/inefficiency.

9.9 Anti-avoidance Rules

Some of the Portuguese DTTs already have limitations of benefits, as well as principal purpose test (PPT)-type provisions. Notwithstanding, the PPT provision should be adopted with the MLI.

Following the examples in other EU countries, the PTA are expected to strengthen their scrutiny of the applicability of double taxation conventions (DTCs). As such, foreign groups with current investments in Portugal should re-evaluate the substance of their investment and financing structures, as well as how they are deploying intangibles in their Portuguese businesses. Portuguese groups using EU holding platforms may

also consider restructuring in light of recent developments in Portugal.

9.10 Transfer Pricing Changes

Since 2000, Portugal has had a transfer pricing regime aligned with the OECD guidelines, and for the time being there are no proposed changes. The tax authorities and clients seek direction in the guidelines, and, as such, any further changes to it might have consequences. Generally, the taxation of profits related to intellectual property has not triggered increased controversy in recent years compared to pre-BEPS levels.

9.11 Transparency and Country-by-country Reporting

The transparency and CbC regimes being proposed and implemented, together with the instruments developed in recent years to exchange information automatically or upon request, contribute positively to a fairer international tax environment.

Ultimately, positive spillovers are to be expected as governments and the international organisations with tax policy roles are able to advance the tax system by enforcing taxation where value is created, in a world where digitalised models are also changing the rules of the game.

From a different perspective, the thresholds defined – namely regarding the application of CbC reporting – ensure that these rules will not disturb the functioning of the economy, particularly in companies that do not have a significant multinational footprint.

9.12 Taxation of Digital Economy Businesses

No substantial changes have yet been implemented to address concerns regarding the taxation of digital economy businesses for CIT purposes.

Recently, Law 74/2020, of November 19th, transposing Directive (EU) 2018/1808 of November 14th, introduced the payment of an advertising tax, applicable to audio-visual on-demand services or video-sharing platform services, as well as an annual levy of 1% payable by audio-visual on-demand service operators (the so-called Netflix Tax).

For VAT purposes, relevant changes have already entered into force to tackle the challenges of allocating indirect taxation rights in a fair manner in the digital economy.

9.13 Digital Taxation

Please see **9.12 Taxation of Digital Economy Businesses**.

9.14 Taxation of Offshore IP

The income paid in relation to offshore IP is subject to withholding tax at the aggravated rate of 35%. Moreover, payments made in connection with offshore IP may not be deductible if the local paying company is not able to demonstrate that such payments correspond to existing operations and are not in an exaggerated amount.

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Authors

Bruno Santiago is a partner at the firm and has extensive experience in corporate reorganisations, M&A, foreign direct investment in Portugal and Portuguese investments overseas, with particular knowledge of the tax systems in Angola and Mozambique. He represents clients in high-profile cases in the tax courts and arbitrations relating to corporate and international tax matters.

António Pedro Braga is a partner at the firm, who has been very active in all areas of tax law, with a special focus on the national and international corporate taxation of finance, industrial and commercial companies. He also has training in the accounting area, having been admitted to the Statutory Auditors Association in 2003.

António Lobo Xavier is a partner at the firm and works with large national and multinational companies, in the areas of finance, telecommunications and industry, as a member of the board of directors, and as an adviser on finance and tax law. He is responsible for several organisational and restructuring operations and M&A, mainly as an expert in subjects related to double taxation treaties, VAT and corporate income tax. He was the Chairman of the latest Corporate Income Tax Reform that was held in 2013.

Francisco de Sousa da Câmara is a partner at the firm, who specialises in tax restructuring operations and M&A transactions for large companies, and in complex corporate tax litigation involving domestic and international tax issues. He also advises high net worth individuals and family structures. Francisco was notably involved in drafting tax legislation, including the General Tax Law, the Proceedings and Procedure Tax Code, and a project for a wealth tax reform. He is a frequent author in several tax-focused publications in Portugal and abroad.

Morais Leitão, Galvão Teles, Soares da Silva & Associados, SP, RL

Rua Castilho, 165
1070-050 Lisboa
Portugal

Tel: +351 213 817 400
Fax: +351 213 817 499
Email: mlgtslisboa@mlgts.pt
Web: www.mlgts.pt