NEWSLETTER 9

Portugal as an investment destination and investment hub

The Portuguese tax regime's role in attracting foreign investment

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Why is Portugal a solid foreign investment destination?

Portugal's legal environment encourages foreign investment. The country has no foreign capital entry restrictions, and Portuguese law prohibits any discrimination between investments based on nationality.

According to United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2020, **foreign direct investment** (FDI) flows to Portugal increased to EUR 6.75 billion in 2019, from EUR 5.52 billion a year earlier. In the same year, the total stock of FDI stood at EUR 132.88 billion, up from EUR 99.62 billion in 2010.

Despite being severely hit by COVID-19 induced crisis, data from OECD shows that FDI inflows decreased by 27.3% to EUR 2.39 billion in the first half of 2020, compared to EUR 3.29 billion recorded in the same period in 2019, but still performing better than the OECD area, where overall inflows dropped by 74%.

Yet, Portugal remains a solid foreign investment destination taking advantage from its several strong points, from which we highlight:

- A skilled and often multilingual **workforce** at a significantly lower cost than other Western European countries;
- A system promoting investment in **innovation and R&D**, which has enabled the country to attract new FDI, essential to its development. The large number of multinationals from all sectors testifies to it;
- Its strategic international relations with **Europe, Africa and America**, in addition to its membership of the European Union, allow Portugal to maintain close ties with **Portuguese speaking countries** such as Angola, Brazil, Macao and Mozambique, and can serve as a gateway to other regional areas such as **SADC**;
- Early sectoral and geographical diversification of **exports**;

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- Political **stability** and fluid governance, combined with one of the safest environments in the world;
- A good **business** environment (the country was ranked 39th on the World Bank's Doing Business 2020 report) and several economic opportunities.

Additionally, as Portugal is one of the European developing areas, it stills benefits from several material EU grants that will be further enhanced under the EU recovery program.

Ok, Portugal is a solid investment destination but how does its tax regime work?

Corporate Income Tax (CIT) is levied on corporate profits derived by both resident and nonresident companies. While **resident companies** are subject to taxation on worldwide profits, **non-resident companies** are only subject to taxation on income deemed to have been obtained in Portugal or on the profits attributable to permanent establishments those non-resident companies maintain herein.

Corporate profits are determined in accordance with the Portuguese accounting standards (generally accepted accounting principles – GAAP), that closely follow the International Financial Reporting Standards (IFRS), but subject to adjustments following the applicable tax provisions.

Generally, corporate profits are subject to CIT at a standard rate of **21% (14,7% for Madeira and 16.8% for Azores)**.

For mainland micro, small and medium companies the tax rate can be reduced to 17% for the taxable profit up to 25k euro (or further reduced to 12.5% for companies in the same

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circumstances but with activities and effective place of management in the inland areas). Under the same circumstances tax rates are of 11.9% in Madeira and 13.6% in Azores).

A so-called State Surcharge (known as *Derrama Estadual*) may also be due depending on the level of the taxable profit, thus introducing a degree of progressivity on the corporate income taxation. For taxable profits in excess of EUR 1.5M and up to EUR 7.5M the tax rate is of 3%; being of 5% for taxable profits exceeding EUR 7.5M up to EUR 35M; and of 9% for taxable profits in excess of such amount (for Azores the tax rates are reduced to, respectively, 2.4%, 4%, and 7.2%).

Municipalities can also levy a local surcharge, known as *Derrama Municipal*, of up to 1,5% of the taxable profit.

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On the other hand, how are investors taxed?

Individuals

PIT relating to distributed profits

Dividends paid to resident individual shareholders are subject to a final Personal Income Tax (PIT) withheld at a 28% tax rate.

Individual resident shareholders can opt to tax the dividends with their remaining income. In such case, 50% of dividends received are subject to PIT at progressive marginal rates. Thus, PIT withheld will be credited against the shareholder's PIT liability and, this being the case, the excess will be refunded.

Dividends paid to non-resident individual shareholders are also subject to a final PIT withholding tax of 28%. **Double tax treaties** (DTT) to avoid or to reduce double taxation may however lower the maximum withholding tax rate on outgoing dividends, usually to a maximum of 10, 12 or 15%.

PIT relating to capital gains

Capital gains derived by resident individuals are subject to tax at a flat rate of 28%. Only 50% of capital gains arising on the sale of shares held on micro and small companies not listed in the stock exchange will be subject to taxation.

Capital gains earned by non-residents individuals are also fully taxable at a flat rate of 28%. A domestic tax exemption may apply to capital gains derived from the disposal of shares or other corporate rights and securities. Tax treaty protection may also be available to non-resident individuals.

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Corporations

CIT relating to distributed profits

There is no withholding tax on dividends paid to resident corporate shareholders, if some requirements are met, namely the participation is not lower than 10% of the share capital and was held for, at least, one year (**participation exemption**).

The same applies to **European Union** corporate shareholders under the Parent-subsidiary Directive on dividends, as well as to some companies from the **Economic European Area** and companies resident at a country with a **DTT in force** with Portugal (under certain conditions).

If the above exemption would not apply, then 50% of dividends received by resident corporate shareholders should be included in the recipient's taxable income.

If the shareholder is a **non-resident entity**, then dividends are subject to CIT to be withheld at a 25% tax rate, except if a DTT should apply. In this case the withholding tax rate will be reduced to a maximum of, usually, 10, 12 or 15%. Dividends paid to entities resident in a blacklisted jurisdiction may be subject to a 35% withholding tax rate. In case the jurisdiction entered a DTT in force with Portugal and is also blacklisted, it seems to be reasonable to understand the DTT should prevail.

Dividends received from non-resident companies can be exempted under the **participation exemption regime** (10% shareholding for more than 12 months, in case of **Portugal, EU, EEA or DTT countries**), provided the distributing company is not resident in a tax haven. If the participation exemption would not apply, the dividend should be included in the taxable profit and **tax credits both for** international **juridical** double taxation (withholding tax at source country) and international **economical** double taxation (CIT paid by the distributing company on the underlying profits) will be granted.

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Under Controlled Foreign Companies (CFC) rules, undistributed profits of some companies resident in a low tax jurisdiction could also be taxable, provided certain positive and negative conditions are met.

CIT relating to capital gains

Capital gains derived by resident corporate entities are included in the taxable profits and subject to the general CIT rate. Likewise, capital losses may be deduced to the taxable profits. Capital gains derived by a resident company on the sale of shares are exempt under the **participation exemption** regime mentioned for dividends (the same conditions must be met). There is however a real estate carve-out for cases where the assets of the company disposed consist of more than 50% of certain Portuguese real estate property. This exemption is also applicable to capital gains derived by permanent establishments of foreign entities operating in Portugal.

Capital gains earned in Portuguese territory by non-resident corporate entities are subject to a 25% flat tax rate.

Capital gains from the disposal of shares or other corporate rights and securities may benefit from a **domestic tax exemption** (the same mentioned to individuals) provided such gains are derived by a non-resident without a permanent establishment in Portugal, if the following requirements are met:

i. The seller is not controlled, directly or indirectly in more than 25% by a Portuguese resident company/individual or the seller is not a resident in a blacklisted jurisdiction; and
ii. The gains derived do not relate to shares or corporate rights in resident companies whose assets consist in more than 50% of certain Portuguese real estate property or in resident holding companies, whenever such companies are in a control relationship

with resident companies whose assets consist in more than 50% of certain Portuguese real estate property.

So far so good, but why can Portugal also serve as an investment hub?

Well, to make cross-border investments happen, investment structures are sometimes set up in jurisdictions benefitting from a stable legal and political environment, a sound financial infrastructure and a highly professional ecosystem.

This is particularly useful when the investments are to be made in countries where an adequate investment facilitation infrastructure is missing, like in developing countries.

Portugal fulfills those criteria and more! And from a tax perspective Portugal reinforces its position as a potential investment hub by offering an **excellent network of DTT and Investment Protection Agreements** (IPA), a sound **participation exemption** regime (inbound and outbound) and a state of the art **international business center and a free trade zone** in Madeira.

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Portuguese double tax treaty network

Portugal has a diversified **network of tax treaties**, with a very interesting and useful coverage of developing jurisdictions, especially the Portuguese speaking countries and related areas of regional cooperation (such as **ASEAN, ECOWAS, Mercosul or SADC**). This enables Portugal to serve as an outstanding investment hub from and to the European Union.

Table of DTT's entered into by Portugal

Country	Tax rates			Blacklisted jurisdictions
	Dividends	Interests	Royalties	
Algeria	15/10	15	10	
Andorra	15/5	10	5	Until 2021
Angola	15/8	10	8	
Austria	15	10	10/5	
Bahrein	15/10	10	5	Yes
Barbados	15/5	10	5	Yes
Belgium	15	15	10	
Brazil	15/10	15	15	
Bulgaria	15/10	10	10	
Canada	15/10	10	10	
Cape Verde	10	10	10	
Chile	15/10	15/10/5	10/5	
China	10	10	10	
Colombia	10	10	10	
Croatia	10/5	10	10	
Cuba	10/5	10	5	
Cyprus	15/10	15	10	
Czech Republic	15/10	10	10	
Denmark	10	10	10	
East Timor	10/5	10	10	
Estonia	10	10	10	
Ethiopia	10/5	10	5	
Finland				
France	15	12/10	5	
Georgia	10/5	10	5	
Germany	15	15/10	10	
Greece	15	15	10	
Guinea-Bissau	10	10	10	
Hong Kong (SAR of PRC)	10/5	10	5	Yes

Country	Tax rates			Blacklisted jurisdictions
	Dividends	Interests	Royalties	
Hungary	15/10	10	10	
Iceland	15/10	10	10	
India	15/10	10	10	
Indonesia	10	10	10	
Ireland	15	15	10	
Israel	15/10/5	10	10	
Italy	15	15	12	
Ivory Coast	10	10	5	
Japan	10/5	10/5	5	
Korea	15/10	15/0	10	
Kuwait	10/5	10	10	Yes
Latvia	10	10	10	
Lithuania	10	10	10	
Luxemburg	15	15/10	10	
Macao	10	10	10	
Malta	15/10	10	10	
Mexico	10	10	10	
Moldova	10/5	10	8	
Montenegro	5/10	10	5/10	
Morocco	15/10	12	10	
Mozambique	10	10	10	
Netherlands	10	10	10	
Norway	15/5	10	10	
Oman	15/10/5	10	8	Yes
Pakistan	15/10	10	10	
Panama	15/10	10	10	Yes
Peru	15/10	15/10	15/10	
Poland	15/10	10	10	
Qatar	10/5	10	10	Yes
Romania	15/10	10	10	

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Country	Tax rates			Blacklisted jurisdictions
	Dividends	Interests	Royalties	
Russia	15/10	10	10	
San Marino	15/10	10	10	Yes
São Tome and Príncipe	15/10	10	10	
Saudi Arabia	10/5	10	8	
Senegal	10/5	10	10	
Singapore	10	10	10	
Slovak Republic	15/10	10	10	
Slovenia	15/5	10	5	
South Africa	15/10	10	10	
Spain	15/10	15	5	
Sweden	10	10	10	
Switzerland	15/5	10	5	
Tunisia	15	15	10	

Country	Tax rates			Blacklisted jurisdictions
	Dividends	Interests	Royalties	
Turkey	15/5	15/10	10	
Ukraine	15/10	10	10	
United Arab Emirates	15/5	10	5	Yes
United Kingdom	15/10	10	5	
USA	15/5	10	10	
Uruguay	10/5	10	10	Yes
Venezuela	10	10	12/10	
Vietnam	15/10/5	10	10/7.5	

Portuguese network of Investment Protection Agreements (IPA)

These agreements are mainly concluded with the purpose of creating favorable conditions for the promotion and creation of investments in the territory of both Contracting Parties.

Furthermore, these agreements provide, on a reciprocal basis, a **most favorable treatment** of investors and ensure that its investments are given an exceptional protection. Most notably, these agreements provide that investments from an investor of one Contracting State within the territory of the other Contracting State cannot be nationalized, expropriated or be subject to any similar measures therein, except in cases of overriding public necessity and provided that a fair compensation, calculated according to the market value, is paid to the investor harmed.

Portugal developed a useful network of IPA, especially for investments in Portuguese speaking countries and related areas of regional cooperation (**ASEAN, ECOWAS, Mercosul, SADC**).

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Together with its network of double tax treaties, the set of investment protection agreements turns Portugal an **outstanding investment hub from and to the European Union**.

List of IPA's already entered by Portugal

Countries	Status
Albania	In force
Algeria	In force
Angola	In force
Argentina	In force
Bosnia and Herzegovina	In force
Brazil	Signed
Bulgaria	In force
Cabo Verde	In force
Chile	In force
China	In force
Congo	Signed
Congo, Democratic Republic of the	Signed
Croatia	In force
Cuba	In force
Czechia	In force
Egypt	In force
Equatorial Guinea	Signed
Gabon	Signed
Germany	In force
Guinea-Bissau	In force
Hungary	In force
Jordan	In force
Korea, Republic of	In force
Kuwait	In force
Latvia	In force
Libya	In force
Lithuania	In force
Macao, China SAR	In force
Mauritius	In force
Mexico	In force
Morocco	Signed
Morocco	In force
Mozambique	In force
Pakistan	In force
Paraguay	In force
Peru	In force
Philippines	In force
Qatar	In force
Romania	In force
Russian Federation	Signed
Sao Tome and Principe	Signed
Senegal	Signed
Serbia	In force
Slovakia	In force
Slovenia	In force
Timor-Leste	In force
Tunisia	In force
Turkey	In force
Ukraine	In force
United Arab Emirates	In force
Uruguay	In force
Uzbekistan	In force
Venezuela, Bolivarian Republic of	In force
Zimbabwe	Signed

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Non habitual resident tax regime and a special residence permit by investment program

The non habitual resident regime with generous personal income **tax exemptions**, the **practical absence of wealth or inheritance taxes**, the **free remittance of funds**, as well as a **friendly residence permit regime** that include a special residence permit by investment program known as Golden Visa, make Portugal a success destination for individuals to establish their investment operations.

To find out more on the non-habitual resident regime and on the Golden Visa program please have a look on our previous Newsletter: "Portugal as a relocation jurisdiction – Still Europe's best kept secret".

Madeira's International Business Centre (IBC), the Portuguese free trade zone

Madeira is a Portuguese island located in the middle of the Atlantic Ocean, close to Europe's southwest coast and Africa's northwest coast.

Madeira International Business Centre (IBC) offers a **whitelisted, totally transparent, not ring fenced and fully European Union (EU) compliant special taxation regime**. The regime is very simple, pragmatic and effective. Furthermore, investors can also apply for general incentives (tax benefits, subsidies and grants).

As the regime is transparent and not ring-fenced, Portuguese tax residents (individuals and corporations) can also benefit from the MIBC regime and Portuguese and EU regulations do apply.

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1. **Tax incentives for companies registered at the Madeira IBC**

The current regime comprises a set of tax incentives **applicable until 31 December 2027** (if not meanwhile extended) to companies **registered until 31 December 2021** in the Madeira IBC.

These tax incentives benefit both the companies and their investors as they include:

- A Corporate Income Tax (CIT) **rate of 5%**;
- An **exemption of 80%** of Stamp Tax (IS), Real Estate Tax (IMI) and Real Estate Transfer Tax (IMT) and CIT surtaxes (*Derrama Regional* and *Derrama Municipal*);
- A withholding tax exemption on **dividends, interests and royalties paid** to non-resident entities (excluding residents in black-listed jurisdictions);

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- A withholding tax exemption on **income derived from services** provided to companies established in the MIBC by non-resident entities (if not attributable to a permanent establishment in Portugal).

Note that the referred CIT rate of 5% is only applicable to income derived from operations with non-resident entities or with other entities registered at the MIBC. The remaining income being subject to the reduced rate of **14,7%** applicable in Madeira (or lower for smaller companies).

2. **Other tax advantages available for companies registered at the Madeira IBC**

As the regime is not ring-fenced, companies registered in Madeira IBC (and their investors) can also benefit from the general Portuguese tax rules and EU regulations, which provide for the following additional advantages:

- A tax exemption on **dividends received** and **capital gains obtained** with the transfer of shares of companies subject and not exempted from CIT (excluding companies resident in black-listed jurisdictions), if a minimum of 10% participation is held for 12 months (participation exemption);
- A withholding tax exemption on **dividends paid** to shareholders holding a minimum 10% participation for a 12 month period that are resident in another EU Member State, in a European Economic Area country bound to administrative cooperation or in a country with which a double tax treaty (DTT) is in force providing for the exchange of information (Parent-subsidiary Directive) – in addition to the exemption provided by the IBC regime to qualifying dividends;
- A withholding tax exemption on **interest and royalties paid** to qualified shareholders resident in another EU Member State or in Switzerland (Interests and Royalties Directive);
- Application of the **tax neutral regime** to mergers, demergers, partial demergers, transfer of assets and exchanges of shares involving companies from two or more EU Member States (Mergers Directive);

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- Application of **Portugal's DTT network**, which comprise 78 jurisdictions;
- Application of the **investment protection treaties** signed by Portugal.

3. Substance requirements and limitations

In order to register at Madeira IBC and apply the referred tax incentives, several substance requirements must be met, essentially relating to the creation of jobs.

Upon incorporation of the company, as a one-off requirement, the following must occur:

- **Creation of 1 to 5 jobs** in the first six months of activity, together with a minimum total CAPEX of **EUR 75 000** during the first two years of activity;
- Alternatively, **creation of a minimum of 6 jobs** during the first six months of activity.

On an ongoing basis, the company must maintain at least **1 job**. Yet, a limitation exists on the taxable profit to which the reduced CIT rate can apply which depends on the numbers of jobs maintained in each period:

- For **1 to 2 jobs** maintained a limit of **EUR 2,730,000** applies;
- For **3 to 5 jobs** maintained a limit of **EUR 3,550,000** applies;
- For **6 to 30 jobs** maintained a limit of **EUR 21,870,000** applies;
- For **31 to 50 jobs** maintained a limit of **EUR 35,540,000** applies;
- For **51 to 100 jobs** maintained a limit of **EUR 54,680,000** applies;
- For **over 100 jobs** maintained a limit of **EUR 205,500,000** applies.

The total tax incentives granted (i.e., the reduced rate of 5% but not the standard rate of 14,7%) are capped at one of the following values:

- 20.1% of the gross value added; or
- 30.1% of the annually incurred labor costs; or
- 15.1% of the annual turnover.

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4. **Activities pursued by companies registered at the MIBC**

Companies registered at the **MIBC may pursue** a set of activities identified under the statistical classification of economic activities NACE Rev. 2, of which we highlight the following:

- Manufacturing;
- Electricity, gas, and water production and supply;
- Wholesale trade;
- Transports and communication;
- Real estate activities;
- Rental and leasing activities.
- Management of holdings in other non-financial companies (i.e., **holding** companies).

Companies pursuing the following activities **are excluded** from the application of this regime:

- Intragroup activities relating to activities of head-offices and business and other management consultancy activities, as well as financial and insurance activities;
- Activities in the steel and synthetic fibers sector;
- Activities in the agriculture, forestry, fishing and aquiculture sector.

Entities deemed as companies in distress or subject to an outstanding recovery order are also excluded from the regime.

We understand activities developed by SGPS, i.e. companies solely engaged in the management of holdings in other non-financial companies (i.e., **pure holding** companies), are allowed activities (see above). Thus we also understand the same entities are also allowed to grant loans and allowed services to affiliates. Then related interest should be subject to reduced DTT rates at source country, lower 5% corporate income tax at residence country (Madeira) with tax credit for withholding tax paid at source (so, no further taxation expected at Madeira level). Furthermore, dividends and interest paid by Madeira company should also be tax exempted.

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As mixed holding companies (i.e. holding companies with a direct activity, e.g. such as trading) are also allowed we also understand they should be granted with the same tax regime.

I understand, can you please summarize the benefits of Portugal as an investment hub?

Sure! That is an easy one.

On top of its strategic location, multicultural environment, skilled labor force and special links with several developing economic areas, Portugal offers several relevant legal and tax advantages, including: large network of international tax treaties, EU incentives and grants, participation regime for inbound and outbound dividends and capital gains, a special PIT regime for non-habitual residents, a friendly residence and citizenship access and (in Madeira) one of the lowest CIT rates in Europe (14,7%), that can be further reduced under the local international business center regime (5%).

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