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Taxation of Cross-Border Mergers and Acquisitions

Portugal

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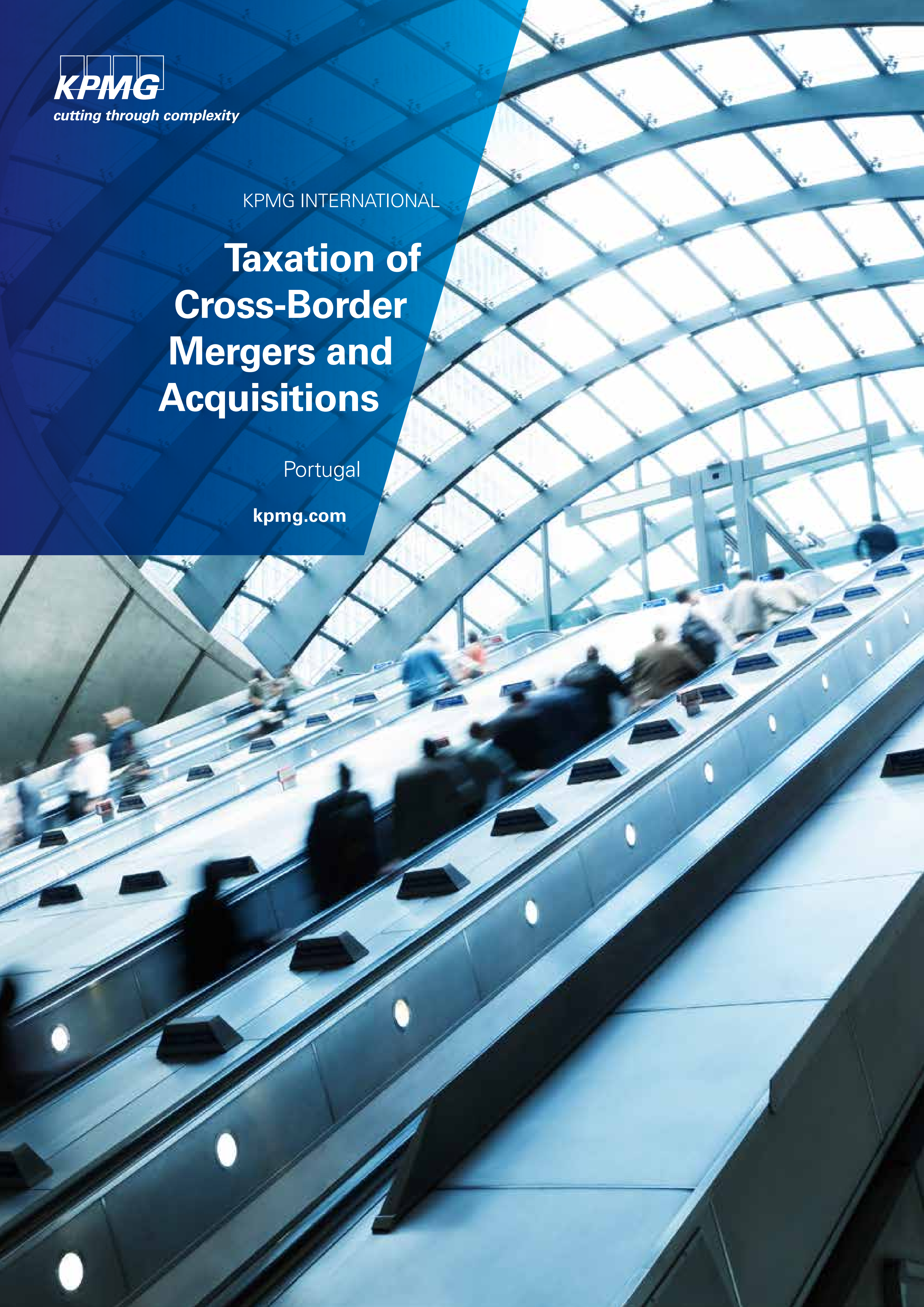

Portugal

Introduction

Portugal's economy suffered significantly due to the 2008 financial crisis. In April 2011, an Economic and Financial Adjustment Program was agreed with the International Monetary Fund (IMF), the European Commission (EC) and the European Central Bank (ECB). As a result, Portugal now shows signs that its economic recovery is on track.

The Adjustment Program, due to be concluded in May 2014, included several commitments from the Portuguese government, including:

- structural reforms
- a fiscal consolidation strategy aimed at reducing the gross public debt-to-GDP ratio in the medium term and reducing the deficit to a sustainable level
- a financial sector strategy based on recapitalization and deleveraging.

In this context, the Portuguese government approved a reform of the corporate income tax (CIT), with effect as of 1 January 2014. The reforms aim toward sustainable development of the Portuguese economy based on private investment and internationalization.

The cornerstones of this reform are simplification, reduction of tax litigation, improved competitiveness, a decreased CIT rate and review of existing tax incentives. Similarly, a personal income tax reform is expected to be proposed during 2014.

Moreover, the tax authorities' structure was reinforced and their methods and their control mechanisms over abusive practices were improved, which is leading to a more effective enforcement.

These developments are already significantly affecting the tax environment in Portugal and the way companies handle their tax affairs and thus their mergers and acquisitions (M&A).

The information in this chapter is based on legislation in force as at 1 January 2014.

This chapter briefly describes the main tax issues that resident and non-resident entities may face in M&A transactions involving Portugal, from both inbound and outbound perspectives.

Asset purchase or share purchase

An acquisition in Portugal is usually conducted through the acquisition of shares in a company, rather than its assets, because an acquisition of assets often triggers real estate transfer tax and stamp duty for the purchaser.

A share sale is also usually more efficient for the seller. Capital gains on the sale of shares may benefit from a full exemption in certain cases, whereas capital gains on a sale of assets are generally fully taxable or only partly exempt at the level of the seller.

Purchase of assets

An asset deal can be more attractive for the purchaser than a share deal because of the non-transfer of tax contingencies faced by the target company, greater flexibility in funding options and the ability of the purchaser to acquire only specific assets.

However, some features of an asset deal make it less tax-efficient, such as real estate transfer tax, stamp duty and the impossibility of transferring to the acquirer eventual tax losses carried forward by the target company.

Purchase price

For tax purposes, the purchase price corresponds to the acquisition value agreed in the respective contract or the property tax value (for real estate assets), whichever is higher.

Transfer pricing rules must be complied with where the deal is undertaken between related entities. Under these rules, the acquisition value agreed between the parties must correspond to the value that would be agreed between non-related entities, in compliance with the arm's length principle.

Goodwill

As of 1 January 2014, the acquisition cost of certain intangible assets with no defined useful life period, namely, goodwill on the acquisition of a business unit (but not shares), can be amortized for tax purposes during a 20-year period.

Depreciation

According to the CIT Code, depreciation costs are allowed for tax purposes based on the rates set out in Regulatory Decree no. 25/2009, dated 14 September 2009.

Land is a non-depreciable asset for tax purposes.

Tax attributes

No tax attributes, such as tax losses carried forward and tax incentives, are transferred to the acquirer as part of an asset deal.

Nevertheless, the limitation for transferring tax losses may be reduced by offsetting them against an eventual capital gain obtained by the seller and the corresponding step-up of the acquisition value of the assets for the acquirer.

Value added tax

According to the Portuguese Value Added Tax (VAT) Code, a sale of assets (or services) is considered a supply of goods (or services) subject to VAT.

However, the transfer of assets as a going concern, whether for consideration or not, or as a contribution to a company, is not subject to VAT, provided certain requirements are met

This no-supply rule serves the purpose of simplicity and is aimed at preventing the successor from being overburdened with a large VAT payment, which can normally be recovered through the input VAT deduction.

Where the recipient is not wholly liable to tax, the tax authorities may take measures to prevent distortion of competition and require VAT adjustments to prevent tax evasion or avoidance through the abuse of this rule.

Where the assets being transferred do not constitute a business unit, the transferred assets (or services) have their own VAT treatment because the seller normally is obliged to charge VAT on the goods (or services) that are being sold, such as stocks and movable goods.

For example, stocks that are sold or contracts that are assigned are normally subject to the VAT standard rate, whereas the sale of real estate, for example, is VAT-exempt.

Therefore, according to the VAT law, a seller that executes a VAT-exempt sale of real estate may be obliged to perform VAT adjustments in the VAT previously recovered.

To avoid these adjustments, the seller and purchaser can jointly opt to waive this exemption and charge VAT on the transaction, provided certain requirements are met.

Where VAT is not charged, the operation is subject to stamp duty. Where the VAT-exemption is waived, no stamp duty is applicable. Either way, any applicable real estate transfer tax is still due.

Transfer taxes

The purchase of assets comprising real estate located in Portuguese territory triggers real estate transfer tax and stamp duty on the acquisition value or the property tax value, whichever is higher. Rates vary from 5 percent to 10 percent for real estate transfer. The stamp duty rate is 0.8 percent. Both taxes are borne by the acquirer.

Some real estate transfer tax exemptions (total or partial) may be available for acquisitions of:

- urban properties in areas benefiting from incentives for less-developed inland areas that are permanently allocated to a company's activities
- assets for resale, where undertaken by a real estate company, provided the assets are re-sold within 3 years
- property by Portuguese real estate investment funds, pension funds and retirement funds
- real estate for development under the Touristic Utility Statute.

Additionally, under certain circumstances, the transfer of assets as a going concern (*Trespasse*) may trigger stamp duty at the rate of 5 percent.

Purchase of shares

The purchase of shares is usually more attractive from a tax perspective for both the purchaser (since it generally does not trigger real estate transfer tax or stamp duty) and the seller (since it facilitates access to a capital gains exemption).

However, a purchase of shares can give rise to significant disadvantages for eventual tax contingencies within the target company.

Therefore, a thorough investigation of the target is essential to identify any possible tax contingencies based on a review of tax returns, documents and procedures. Such a review should cover all taxes, including CIT, VAT, personal tax, stamp duty and social security contributions.

Tax indemnities and warranties

Under a purchase of shares, tax liabilities and claims are transferred with the target companies, although protection may be sought in the sale-purchase agreement or any formal letter signed by both parties.

Any future assessment by the tax authorities will continue to be claimed from the target company, so usually the purchaser requests and the vendor provides indemnities or warranties regarding any undisclosed tax liabilities of the target company.

The Portuguese tax law operates a system of self-assessment under which companies are subject to periodic tax audits by the tax authorities for most taxes, after which tax assessments can be raised in respect of the preceding 4 fiscal years. Until this period has expired, tax returns are not closed but remain open for review and inspection.

Where companies have tax losses, the period open to fiscal audits may be extended to the period during which the tax losses can be carried forward.

For social security purposes, a tax audit and assessment may be carried out for the preceding 5 fiscal years. Real estate transfer tax is open for tax audit and assessment for 8 years.

Tax losses

In Portugal, tax losses may be offset against taxable profits assessed until the twelfth subsequent year (the carry forward period is 6 fiscal years for tax losses assessed prior to 2010, 4 fiscal years for tax losses assessed in the fiscal years of 2010 and 2011, and 5 fiscal years for tax losses assessed until 2014).

The deduction of tax losses is now limited to 70 percent of the taxable profit. This limit applies for tax losses arising in fiscal years ending before or including 1 January 2014.

The deductibility of tax losses is restricted where there is a change of ownership of more than 50 percent of the share capital of a company or of most of its voting rights, although several exceptions may apply.

Utilization of tax losses carried forward requires pre-authorization from the tax authorities in response to a request filed by the company in advance, explaining its economic reasons. This request is not automatically approved by the Portuguese tax authorities and is subject to a case-by-case analysis.

Pre-sale dividend

Portuguese tax law has no specific rules for the distribution of a pre-sale dividend.

Under Portuguese tax law, dividends paid by a Portuguese subsidiary to a non-resident entity are subject to withholding tax (WHT) at a flat rate of 25 percent, which may be reduced by a tax treaty (for entities resident in tax havens, the rate is increased to 35 percent). The Portuguese CIT Code foresees a CIT exemption (and thus no WHT obligation) for dividends distributed by Portuguese-resident companies to entities resident in a country (i) of the European Union (EU); (ii) of the European Economic Area (EEA), where bound to an administrative cooperation mechanism similar to the one established in the EU; or (iii) with whom Portugal has entered into a tax treaty and such agreement foresees a similar administrative cooperation agreement to the one above. The exemption also depends on the following:

- The non-resident shareholder is subject to and not exempt from one of the income taxes referred in article 2 of Council Directive 2011/96/EU, of 30 November 2011 (Parent-Subsidiary Directive) or an income tax that is similar to the Portuguese CIT, as long as the statutory tax rate applicable is not lower than 60 percent of the Portuguese CIT rate, which is currently 23 percent.
- The non-resident shareholder holds directly, or directly and indirectly, a participation in the Portuguese company's share capital or voting rights of at least 5 percent and has held that participation continuously during the 24 months preceding the dividend distribution.

A global participation exemption regime has been adopted for dividends obtained by Portuguese entities, excluding those obtained from tax havens, provided the following requirements are met:

- The beneficiary holds at least 5 percent of the share capital or voting rights, and the participation has been continuously held throughout the 24 months prior to the distribution of the profits or is maintained during that period.
- The company distributing the profits is not exempt from CIT and is subject to a tax referred to in the EU Parent-Subsidiary Directive or similar tax whose rate is not lower than 60 percent of the CIT rate, or, where this requirement is not met, where most of its profits are derived from a business activity or its assets are not qualified as portfolio investments.

Transfer taxes

Although real estate transfer tax generally is not due on a share deal, the Portuguese Real Estate Transfer Tax Code states that the acquisition of a private limited liability company (Lda.) holding real estate that implies a single shareholder owning a participation of at least 75 percent is subject to real estate transfer tax.

In this case, the Real Estate Transfer Tax Code establishes that the tax base is the higher of:

- the property tax value
- the book value of the assets, as stated in the company's balance sheet.

The real estate transfer tax is due by the acquirer of the share capital and should be paid before registering the public deed of acquisition.

The tax rate varies from 5 percent to 6.5 percent (normally 6.5 percent).

This tax is not due on transactions of public limited liability companies (S.A. companies).

No stamp duty is due on a purchase of shares.

Choice of acquisition vehicle

The choice of the acquisition vehicle largely depends on the nature of the transaction (asset or share deal), the nature of the assets involved, the financing structure and the nature of the income to be extracted from the target company.

The following vehicles may be used in an acquisition of shares or assets:

- Portuguese holding company
- foreign parent company
- non-resident intermediate holding company
- Portuguese branch
- joint venture.

Local holding company

Under Portuguese law, a Portuguese pure holding company, *Sociedade Gestora de Participações Sociais* (SGPS), is incorporated as a regular company (S.A. or Lda.), but has a specific social purpose in its articles of incorporation restricted to the holding and management of share capital participations.

As such, an SGPS company is subject to the same tax obligations and, as of 2014, the same tax regime as a regular company.

Participation exemption regime for capital gains

Under the participation exemption regime for capital gains, and subject to the same conditions as the participation exemption regime for dividends, capital gains and losses assessed by a Portuguese company from the sale of shares are not taxable or deductible unless more than 50 percent of the assets of the company whose shares are being sold are composed real estate assets located in Portugal and held for resale.

Foreign parent company

Where the Portuguese subsidiaries are held by a foreign parent company, the corresponding tax implications vary significantly, depending on the country in which the parent company is resident.

Apart from differences among Portugal's tax treaties with other countries, there are significant differences in tax treatment depending on whether the parent company is located in or outside the EU, EEA or treaty country where the treaty foresees the same administrative cooperation as discussed in this chapter's earlier section on pre-sale dividends.

Where the parent company is located in the EU (or the other mentioned territories), in addition to the possibility of reduced WHT rates under tax treaties, the parent company may also benefit from a WHT exemption on dividends, as explained in this chapter's earlier section on pre-sale dividends.

On the other hand, the parent company only benefits from reduced WHT rates where the corresponding country has signed a tax treaty with Portugal.

Portugal's tax treaties generally do not entitle Portugal to tax capital gains. However, a foreign parent company (EU-resident or not) may benefit from an exemption on capital gains on the sale of share capital participations in Portuguese-resident companies unless:

- The parent company is owned, directly or indirectly, in 25 percent or more by a Portuguese tax-resident entity.
- The parent company is resident in a tax haven jurisdiction.
- More than 50 percent of the assets directly or indirectly held by the Portuguese company consist of real estate property located in Portugal.

Local branch

A branch of a foreign company is subject to Portuguese CIT on its attributable income at the rate of 23 percent. In addition, a state surcharge applies to the part of the taxable profit exceeding 1.5 million Euros (EUR) as follows:

- from EUR1.5 million to EUR7.5 million: 3 percent
- more than EUR7.5 million: 5 percent
- more than EUR 35 million: 7 percent.

This taxation may be increased by a municipal surcharge of up to a maximum of 1.5 percent levied over the taxable income, giving rise to a maximum standard CIT rate of 31.5 percent. There is no WHT on distributions to the foreign head office.

A commercial disadvantage of a branch may be that the branch is not a separate legal entity, leaving the head office fully exposed to the liabilities of the branch. Additionally, the tax authorities may deny the deduction of interest charged or allocated to the branch by the head office, depending on the circumstances.

Under Portuguese tax law, profit distributions to, and their receipt by, a Portuguese permanent establishment of a parent company located in the EU, EEA or treaty country where the treaty foresees the same administrative cooperation as discussed in this chapter's earlier section on pre-sale dividends, have the same treatment as a Portuguese company.

Joint ventures

Generally, joint ventures are set up as regular Portuguese companies held by the joint venture partners.

Choice of acquisition funding

Funding is critical to the success of a transaction. The appropriate mix between debt and equity and the different types of debt may have a significant tax impact under Portuguese law, as summarized below.

Debt

Apart from WHT on interest, financing operations undertaken within a group with Portuguese-resident companies may also trigger significant tax charges under stamp duty.

Although exemptions may apply, the costs of setting up stamp duty-efficient debt structures may exceed the related tax savings.

Earnings stripping rules

Generally, interest costs are deductible for tax purposes provided they are considered necessary for generating the taxable income or undertaking the company's activity.

According to the earnings stripping rules, the deductibility of net financing expenses (interest and other) is limited to EUR1 million or 30 percent of earnings before net interest, taxes, depreciation and amortization (EBITDA), whichever is higher.

During a transitional period, the EBITDA limit is 60 percent in 2014, 50 percent in 2015, 40 percent in 2016, and 30 percent in 2017.

Any amounts of net interest and other financing expenses that exceed the applicable limit (and are not tax-deductible) may be carried forward and offset against the taxable profit of the following 5 years, together with the net interest and other financing expenses of that year, to the extent they do not exceed both limits.

In addition, where the net interest and other financing expenses deducted for tax purposes do not exceed 30 percent of the EBITDA, the part of the limit that was not exceeded can be considered for the purposes of increasing the limits applicable in the following 5 years. The limits foreseen in the transitional period are not relevant for this purpose.

Where the group relief regime applies, this limitation could be applied to the group's EBITDA, provided certain requirements are fulfilled.

Transfer pricing

Under transfer pricing rules, interest charged between related entities must be agreed under the same conditions as the ones settled between entities that do not have a special relationship.

See this chapter's information on transfer pricing for more details.

Transfer taxes

Stamp duty is levied on the use of credit, in any form, at rates that vary according to the maturity of the loan, as follows:

Credit maturity	Rate
Less than 1 year	0.04 percent (per month or part month)
One year or more	0.5 percent
Five years or more	0.6 percent

Source: KPMG in Portugal, 2014

Credit in the form of a current account, bank overdraft or any other form in which the maturity is not determined or determinable is subject to stamp duty at a rate of 0.04 percent on the average monthly balance, calculated by dividing the sum of the daily debt balance by 30.

In addition, stamp duty applies at the rate of 4 percent on interest charged by credit institutions, financial companies or other financial entities.

Some exemptions from stamp duty may be available, for example, on shareholder loans where the parties establish an initial period of no less than one year during which no reimbursement occurs.

Bonds and commercial paper

Bonds and commercial paper are not subject to stamp duty, in compliance with the Council Directive 69/335/EEC of 17 July 1969 on indirect taxes on the raising of capital.

Deductibility of interest

Interest charged to Portuguese-resident companies is generally deductible for tax purposes, provided the loan is related to the company's activity, the earnings stripping rules are observed, and, where granted by related entities, the interest complies with limitations under the transfer pricing rules.

Withholding tax on debt and methods to reduce or eliminate it

WHT on interest applies at a rate of 25 percent, which may be reduced under a tax treaty or by applying the provisions of the EU Council Directive 2003/49/EC (Interest and Royalties Directive). No WHT applies to interest on loans granted by a non-resident financial institution to a Portuguese-resident credit institution.

WHT exemptions may apply to interest charged on bonds, provided certain requirements are met.

Checklist for debt funding

- Interest expenses are deductible for CIT purposes provided they are deemed necessary for generating taxable income or maintaining the production source, although deductibility may be limited by the earnings stripping rules.
- Compliance with the transfer pricing rules where the funding occurs between related parties.
- Relief for WHT on interest may be obtained under a tax treaty (partial) or the Interest and Royalties Directive (full).
- To benefit from stamp duty exemptions regarding the principal amount and/or the interest, the intervening entities should carefully address the nature of the financing, the existing lender-borrower relationship and the repayment period.

Equity

Micro, small and medium-sized companies are entitled to a deduction of 5 percent of the share capital, corresponding to cash contributions of the shareholders for incorporating the company or increasing its share capital.

In order to benefit from this deduction, some requirements must be met, including that the shareholders must be individuals or venture capital companies/investors.

Dividends

Dividends paid by a Portuguese subsidiary to a non-resident entity are subject to WHT at a flat rate of 25 percent, which may be reduced under a tax treaty signed by Portugal.

In addition, no WHT applies, provided certain requirements are met. For example, the parent company has held a minimum of 5 percent of the share capital of the Portuguese affiliate for a minimum of 24 months.

Where the minimum holding period is not met at the time the dividends are distributed, the parent company can file a reimbursement claim with the Portuguese tax authorities within a two-year period from the end of the minimum holding period.

Reorganizations

As a result of the transposition of the EU Merger Directive, the Portuguese tax law foresees a special tax neutral regime for certain operations performed as part of group reorganizations. Among other conditions, this regime only applies to operations performed for sound economic reasons (i.e. which do not have tax avoidance as their sole or main purpose).

The operations discussed in the following sections may qualify for the special tax neutrality regime.

Merger (*fusão*)

A merger qualifying for tax neutrality occurs in the following circumstances:

- where one or more companies transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders of shares representing the share capital of that other company and, where applicable, a cash payment not exceeding 10 percent of the nominal value of the shares attributed or, in the absence of a nominal value, the accounting par value of those shares
- where one or more companies transfer all their assets and liabilities to a company to be incorporated in exchange for the issue to their shareholders of shares representing the share capital of that new company and, where applicable, a cash payment not exceeding 10 percent of the nominal value of the shares attributed or, in the absence of a nominal value, the accounting par value of those shares
- where a company transfers all its assets and liabilities to the company holding all the shares representing its share capital
- where a company transfers all its assets and liabilities to another existing company and both companies have the same shareholder
- where a company transfers all its assets and liabilities to another company and the share capital of the latter is entirely hold by the former (downstream merger).

Demerger (*cisão*)

A demerger qualifying for tax neutrality may take one of the following forms:

- simple demerger, whereby a company, without being extinguished, transfers one or more business units (keeping at least one business unit) to a new company, in exchange for the pro rata issue to its shareholders of shares representing the share capital of the new company, and, eventually, a cash payment not exceeding 10 percent of the nominal value of the shares or, in the absence of a nominal value, the accounting par value of those shares
- demerger/merger, whereby a company, without being dissolved, transfers one or more business units (keeping at least one business unit) to an existing company, in exchange for the pro rata issue to its shareholders of shares representing the share capital of the new company, and, eventually, a cash payment not exceeding 10 percent of the nominal value of the shares or, in the absence of a nominal value, the accounting par value of those shares
- demerger-dissolution, whereby a company, on being dissolved, transfers its assets and liabilities to two or more companies to be incorporated or to merge them with existing companies or with assets and liabilities of companies divided by similar processes and with the same purpose, in exchange for the pro rata issue to its shareholders of shares representing the share capital of the existing companies or of the new companies and, eventually, a cash payment not exceeding 10 percent of the nominal value of the shares attributed or, in the absence of a nominal value, the accounting par value of those shares.

Other demergers may be carried out under the tax neutrality regime whereby:

- a company transfers one or more business units (keeping at least one business unit) to its single shareholder
- a company transfers one or more business units (keeping at least one business unit) to another existing company and both companies have the same shareholder
- a company transfers one or more business units (keeping at least one business unit) to another company and the share capital of the latter is entirely held by the former.

Contribution in kind (*entrada de activos*)

Contribution in kind is an operation whereby a company transfers, without being dissolved, all or one or more business units to another company, in exchange for shares representing the share capital of the company receiving the business unit(s).

Exchange of shares (*permuta de partes sociais*)

An exchange of shares is an operation whereby a company acquires a share capital participation in another company, which grants it the majority of the voting rights in that company or whereby a company already owning the majority of the voting rights acquires a new participation in the same company, in exchange for the issue to the shareholders of the latter company, in exchange for their shares, of shares representing the share capital of the former company and where applicable, a cash payment not exceeding 10 percent of the nominal value of those shares or, in the absence of a nominal value, the accounting par value of the shares issued in exchange.

For the purposes of the special tax neutrality regime, a business unit is defined as all the assets and liabilities of a division of a company that, from an organizational point of view, constitute an independent unit; that is, an entity capable of functioning by its own means.

The above-noted operations involving non-Portuguese EU-resident companies may also benefit from the special tax neutrality regime, subject to the fulfilment of certain conditions.

Hybrids

The current Portuguese tax law does not include rules for hybrids. The law was amended to disregard, for tax purposes, reclassifications made for accounting purposes. However, the amended law does not stipulate how the income arising from such financing instruments should be treated for tax purposes.

Discounted securities

Under Portuguese tax law, expenses associated with the issue of discounted securities, such as bonds, are tax-deductible, provided they are essential for realizing profits and gains subject to CIT or for maintaining the production source.

Because discounted securities correspond to non-interest-bearing money market instruments issued at a discount and redeemed at maturity for full face value, income obtained by the company on the securities' maturity is subject to CIT at a rate of up to 31.5 percent.

Deferred settlement

Where settlement of the consideration is deferred, the acquirer should address the following issues:

- Where the transaction involves related parties, interest may have to be charged over the deferral period to comply with the transfer pricing rules.
- Where the deferral period is significant, there is a risk that the deferred consideration will be deemed as a financing and, therefore, subject to stamp duty.

Other considerations

Concerns of the seller

The possibility of achieving capital gains exemption leads most sellers to prefer a share deal over an asset deal.

Company law and accounting

The Portuguese Commercial Companies Code sets out the conditions under which a merger demerger and contribution in kind can take place.

The Code creates a simplified merger regime for situations involving a company wholly owned by the merging company. This regime has been extended to include situations involving minority shareholders (holding a maximum of 10 percent of the shares of the company being merged). Several legal procedures are waived for the intervening entities, thereby simplifying the bureaucratic process.

In this regard, the new Portuguese generally accepted accounting principles (GAAP) establish that, where the cost of a merger for the merging company at fair market value is higher than the net assets of the merged company, the difference must be allocated to the assets and liabilities transferred that can be identified.

However, this type of imputation is not accepted for tax purposes.

Currently, Portuguese GAAP requires that any difference between the net assets being merged and the value of the share capital participation held by the merging company in the company being merged should be accounted for as a merger reserve and included in an equity account.

The adoption of International Financial Reporting Standards (IFRS) for Portuguese tax purposes has not changed the tax treatment of mergers, demergers, contributions in kind and exchanges of shares.

Group relief/consolidation

A qualifying group for the group relief regime consists of a parent company holding, directly or indirectly, a share capital participation of at least 75 percent in one or more subsidiaries, provided that the participation represents more than 50 percent of the voting rights.

The following main conditions must also be met:

- The parent company did not waive the application of this regime in the previous 3 years.
- The parent company is not owned by another Portuguese-resident company also qualifying as parent company under the group relief regime.
- The share capital participation was held for more than one year prior to the beginning of the application of the regime. This requirement does not apply to companies incorporated by the parent company where the participation has been held since the date of incorporation.
- The registered head office and effective place of management of the parent company and its subsidiaries are in Portuguese territory.

Companies indirectly held by the parent company through companies resident in the EU or EEA also qualify for the 75 percent shareholding requirement.

For the regime to apply, the parent company must notify the tax authorities of its adoption. The regime remains valid indefinitely where there are no changes in the group that trigger its cessation.

The tax group cannot include companies that:

- have tax losses carried forward in the 3 years prior to the start of the regime, except where the share capital participation is held by the parent company for more than 2 years
- are inactive for more than one year or have been dissolved
- are in a bankruptcy or judicial recovery procedure
- are subject to a more favorable corporate income tax rate and have not waived this benefit
- have a tax year different from that of the parent company
- do not assume the legal form of an Lda. company, S.A. company or partnership by shares.

The group's taxable profit is determined by adding together each company's tax result, thereby obtaining an aggregated taxable profit or loss.

Intragroup dividends, interest and royalties paid among the companies of the group are not subject to WHT, provided this income relates to periods during which the group relief regime was in force.

The regime ceases to apply whenever any of the necessary requirements are not met or the tax authorities assess the taxable income of any company of the group companies through indirect methods (applied in exceptional cases when the accounting records of the company are not considered to be reliable).

Where the parent company ends up being held by another company that qualifies as the parent company of the group, the latter may opt for the continuation of the regime, provided the tax authorities are informed within 30 days following the inclusion of the new parent company.

On termination of the regime, all unused tax losses generated while the regime was in force are lost.

Transfer pricing

The Portuguese transfer pricing legislation, which generally follows the guidelines of the Organisation for Economic Co-operation and Development (OECD), as well as other good practices adopted by countries with a longer tradition in these matters, applies to fiscal years starting on or after 1 January 2002.

Under the Portuguese transfer pricing regime, the taxpayer has certain documentation and filing obligations. As a result of its documentation obligations and as a general rule, taxpayers with annual sales and other income greater than or equal to EUR3 million, in the fiscal year prior to the year under consideration, need to prepare contemporaneous transfer pricing documentation supporting the arm's length nature of their transactions with related parties. The documentation must be maintained for 10 years.

Transfer pricing documentation must comply with certain requirements set out in transfer pricing legislation, such as:

- a functional analysis, which aims to describe the functions performed, risks assumed and assets employed in the related-party transactions
- an economic analysis, which demonstrates the arm's length nature of the terms and conditions established in transactions carried out between related parties.

The relationship threshold for transfer pricing rules that apply between related parties is, among others, a share ownership equal to or greater than 20 percent.

Under the Portuguese transfer pricing regime, the taxpayer has certain filing obligations. In terms of the Annual

Simplified Accounting and Tax Return, taxpayers must fill in the intragroup transactions' amounts (established with resident and non-resident entities) and disclose the existence of contemporaneous transfer pricing documentation and methods applied in the economic analyses performed.

In July 2008, the Portuguese tax authorities released the detailed requirements and conditions for submitting requests for unilateral, bilateral and multilateral advance pricing agreements (APA).

Dual residency

Under Portuguese tax law, a company qualifies as tax-resident where it has its headquarters or its place of effective management located in the Portuguese territory.

Portugal's tax treaties include rules to avoid situations of dual residency. In the experience of KPMG in Portugal, no issues have been raised by the Portuguese tax authorities with regard to dual residency.

Foreign investments of a local target company

The Portuguese tax law attributes profits obtained by foreign companies resident in tax haven jurisdictions to a Portuguese-resident entity where it holds, directly or indirectly (even where through an agent, trustee or intermediary), at least 25 percent of the share capital of the foreign companies. This percentage is reduced to 10 percent where the company located in a tax haven is held, directly or indirectly (even where through an agent, trustee or intermediary, more than 50 percent by Portuguese-resident entities.

This anti-avoidance rule is not applicable (among other situations) where:

- the non-resident entity is resident for tax purposes in an EU or EEA Member State (provided the Member State is bound to provide administrative cooperation on taxation equivalent to the one that exists within the EU)
- the entity is set up and maintained for valid economic reasons
- the entity primarily carries on an agricultural, commercial, industrial or services activity.

Comparison of asset and share purchases

Advantages of asset purchase

- Possible to acquire a specific part of a company.
- Deductibility of higher depreciation costs in most cases.
- No previous (tax) liabilities of the company are inherited.
- Greater flexibility in funding options.

Disadvantages of asset purchase

- Possible need to renegotiate supply, employment and technology agreements.
- May be unattractive to the vendor because of capital gains taxation, thereby increasing the price.
- May be subject to transfer taxes and stamp duty.
- May constitute a VAT event.
- Certain items are not depreciable (e.g. goodwill, although goodwill related to assets acquired as from 1 January 2014 can be deducted for tax purposes, in equal parts, during the first 20 tax years following its initial accounting register).
- Accounting profits may be affected by the creation of acquisition goodwill.
- Benefit of tax losses incurred by the target company remains with the vendor.

Advantages of share purchase

- May benefit from existing supply or technology contracts.
- More flexibility to achieve capital gains exemption for the vendor, thereby reducing the price.
- Not subject to transfer tax in most cases.
- Buyer may benefit from tax losses of target company (subject to limitations).

Disadvantages of share purchase

- Transfer of outstanding claims and possible hidden liabilities.
- No deduction for purchase price.
- Less flexibility in funding options.

Portugal – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Portugal's tax treaties. This table is based on information available up to 1 January 2014.

Source: International Bureau of Fiscal Documentation, 2014

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Domestic rates				
Companies:	25/35	0	0/5/25/35	0/25/35
Individuals:	0/28/35	N/A	28/35	25/35
Treaty rates				
Treaty with:				
Algeria	15	10[3]	0/15[4]	10
Austria	15	15	10	5/10[5]
Belgium	15	15	15	10
Brazil	15	10	15	15
Bulgaria	15	10	0/10	10
Canada	15	10	0/10	10
Cape Verde	10	10	0/10	10
Chile	15	10	5/10/15[6]	5/10[7]
China (People's Rep.)	10	10	10	10
Cuba	10	5	0/10	5
Cyprus[8]	10	10	10	10
Czech Republic	15	10	0/10	10
Denmark	10	0[9]	0/10	10
Estonia	10	10	10	10
Finland	15	10	15	10
France	15	15	10/12	5
Germany	15	15	10/15[10]	10
Greece	15	15	15	10
Guinea-Bissau	10	10	10	10
Hong Kong[11]	10	5[12]	10	5

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Hungary	15	10	0/10	10
Iceland	15	10	0/10	10
India	15	10	0/10	10
Indonesia	10	10	10	10
Ireland	15	15	0/15	10
Israel	15	10/5	10	10
Italy	15	15	0/15	12
Japan	10	5[13]	5/10[14]	5
Korea (Rep.)	15	10	0/15	10
Kuwait	10	5	10	10
Latvia	10	10	10	10
Lithuania	10	10	10	10
Luxembourg	15	15	10/15[15]	10
Macau	10	10	0/10	10
Malta	15	10	10	10
Mexico	10	10	0/10	10
Moldova	10	5	10	8
Morocco	15	10	12	10
Mozambique	10	10	0/10	10
Netherlands	10	0	0/10	10
Norway	15	5[16]	10	10
Pakistan	15	10	0/10	10
Panama	15	10	10	10
Poland	15	10	0/10	10
Romania	15	10	0/10	10
Russia	15	10	0/10	10
Singapore	10	10	0/10	10
Slovak Republic	15	10	10	10
Slovenia	15	5	10	5
South Africa	15	10	10	10

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Spain	15	10	15	5
Sweden	10	0	0/10	10
Switzerland	15	5	10	5
Tunisia	15	15	15	10
Turkey	15	5	10/15[17]	10
Ukraine	15	10	0/10	10
United Arab Emirates	15	5	10	5
United Kingdom	15	10	10	5
United States	15	5	0/10	10
Uruguay	10	5	10	10
Venezuela	10	10	0/10	10/12[18]

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, or export credit institutions or in relation to sales on credit. Such exemptions are not considered in the column.
2. Unless stated otherwise, the reduced treaty rates given in this column generally apply if the recipient company holds directly or indirectly at least 25 percent of the capital or the voting power, as the case may be, of the company distributing dividends.
3. The rate applies if the recipient company has held directly at least 25 percent of the capital in the Portuguese company continuously for at least 2 years preceding the payment.
4. The zero rate applies, inter alia, to interest paid by public bodies.
5. The rate is 10 percent for payments by a company to an Austrian resident holding more than 50 percent of its capital.
6. The 5 percent rate applies to interest from bonds or securities regularly and substantially traded on a recognized securities market and the 10 percent rate to interest from loans granted by banks and insurance companies, and sales on credit of machinery and equipment where the beneficial owner is the seller.
7. The lower rate applies to royalties from the use of, or right to use, any industrial, commercial or scientific equipment.
8. Effective from 1 January 2014.
9. Under this treaty, the exemption applies to dividends qualifying for the EU Parent-Subsidiary Directive.
10. The rate is 10 percent for interest on loans granted by a bank if the operation for which such loans are granted is officially deemed to be of economic or social interest for Portugal.
11. Effective from 1 January 2013 for Portugal, and from 1 April 2013 for Hong Kong.
12. The rate is 5 percent if the recipient is a company (other than a partnership) which holds, directly, at least 10 percent of the capital of the Portuguese company paying the dividends.
13. The rate is 5 percent if the Japanese company (other than a partnership) has owned, directly, for the period of 12 months, at least 10 percent of the capital in the Portuguese company.
14. The 5 percent rate applies if the beneficial owner of the interest is a bank.
15. The rate is 10 percent for interest that is paid to a Luxembourg financial establishment and is a deductible expense for the Portuguese company.
16. This rate applies if the recipient is (i) a company (other than a partnership) that has for an uninterrupted period of at least 12 months prior to the payment of the dividends held directly at least 10 percent of the capital of the company paying the dividends; (ii) either contracting state or a political or administrative subdivision or a local authority or the central bank thereof; or (iii) the Government Pension Fund (in the case of Norway) or *fundos de capitalizacão administrados por entidades públicas* (in the case of Portugal).
17. The lower rate applies to interest paid on a loan made for a period of more than 2 years.
18. The 10 percent rate applies to payments for technical assistance.

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