



MERGERS AND ACQUISITIONS

Portugal

Taxation of Cross-Border
Mergers and Acquisitions

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TAX

Portugal

Introduction

A number of recent developments are expected to have a significant impact on the tax environment in Portugal and on the way companies handle their tax affairs and thus their mergers and acquisitions (M&A).

These developments have been aimed at achieving three main goals: simplify the formal requirements for complying with tax law, provide the tax authorities with more control over abusive practices, and align the Portuguese accounting and tax rules with the International Financial Reporting Standards (IFRS).

The information in this chapter is based on legislation in force as at 30 September 2009. In addition, since from 1 January 2010 the Portuguese tax rules will change significantly as a result of the adoption of the IFRS, the implication of these standards will also be examined whenever they have a significant impact on the matters addressed.

In summary, what follows is a brief description of the main tax issues that resident and non-resident entities may face in M&A transactions involving Portugal, both from an inbound and an outbound perspective.

Recent Developments

Portugal has recently enacted tax and commercial legislation with a direct impact on M&A transactions, namely:

- the simplification of the administrative process to apply for exemption of real estate transfer tax on the transfer of assets within restructuring operations; and
- the simplification of the legal acts to be complied with under the Portuguese Commercial Companies Code within restructuring operations (mergers and de-mergers).

With regards to the latter, the main changes relate to the possibility of concluding mergers and de-mergers in just one month; the application of the simplified merger regime to situations which involve minority shareholders and the availability of electronic standard documentation for mergers and de-mergers, enabling a 50-percent

reduction in the administrative costs associated with the commercial registry of these operations.

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, because an exemption may apply to capital gains on the sale of shares whereas capital gains on a sale of assets are fully taxable 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 on the funding options, and the ability of the purchaser to acquire only specific assets.

However, there are some features of an asset deal that make it less tax-efficient, for example, 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 (in the case of real estate assets), whichever is higher.

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

Goodwill

The Portuguese tax law does not allow goodwill to be depreciated.

Depreciation

According to the rules set out in the Corporate Income Tax (CIT) Code, depreciation costs are only allowed for tax purposes if based on the rates set out in Regulatory Decree no. 2/90, of 12 January (until 31 December 2009) and in Regulatory Decree no. 25/2009, of 14 September (from 1 January 2010 onwards).

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 can be reduced through their offset 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 (VAT)

According to the VAT Code, a sale of assets (or services) will be considered a supply of goods (or services) subject to VAT.

Despite this, the transfer of assets as a going concern, whether for consideration or not, or as a contribution to a company, will not be subject to VAT.

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

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

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

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

Therefore, according to the VAT law, the seller, when executing 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, together with the purchaser, can opt, provided certain requirements are met, to waive this exemption and charge VAT in the transaction.

Note that if VAT is not charged, the operation will be subject to stamp duty. If the VAT exemption is waived, no stamp duty will be applicable. Either way, the real estate transfer tax, if applicable, will still be due.

Transfer Taxes

The purchase of assets, namely 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, at rates that vary between 5 percent and 8 percent for real estate transfer tax and 0.8 percent for stamp duty. Both taxes are to be borne by the acquirer.

However, there are some exemptions from real estate transfer tax:

- Acquisitions of urban property in areas benefiting from incentives for less developed inland areas that is permanently allocated to the company's activities.
- Acquisition of assets for resale, if undertaken by a real estate company, provided that the assets are resold within three years.
- Acquisitions of property by Portuguese real estate investment funds, pension funds, and retirement funds. If the acquisition is by mixed or closed-end privately placed real estate funds, held by non-qualified investors, or by financial institutions acting on their behalf, the exemption is not applicable, but the tax rate is reduced by half.
- The acquisition of real estate for development under the Touristic Utility Statute.

Purchase of Shares

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

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

A thorough investigation of the target is, therefore, 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 corporate income tax, VAT, personal tax, stamp duty, and social security contributions.

Tax Indemnities and Warranties

Under a purchase of shares, tax liabilities and claims are transferred to the acquirer, unless specifically excluded in the sale and purchase agreement or any formal letter signed by both parties.

As any future assessment by the tax authorities will continue to be claimed from the target company, it is usual for the purchaser to request, and for the vendor to provide, indemnities or warranties as to any undisclosed tax liabilities of the target company.

Please note that 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 four fiscal years. Until this period has expired, tax returns cannot be considered as closed and, consequently, remain open for review and inspection.

When companies present 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 five fiscal years. real estate transfer tax is open for tax audit and assessment for eight years.

Tax Losses

In Portugal, tax losses may be offset against taxable profits assessed until the sixth subsequent year.

The deductibility of tax losses is restricted when:

- there is a change of ownership of at least 50 percent of the share capital of a company or of most of its voting rights;
- whenever the corporate purpose of the respective entity is changed; or
- the nature of the activity carried out by the entity is substantially changed.

Although tax losses carried forward may be maintained in the situations described earlier, this requires a granting by the tax authorities of a request to be filed by

the company before those events occur, explaining the economic reasons underlying any of the above-mentioned situations. This request is not automatically approved by the Portuguese tax authorities and is subject to a case-by-case analysis.

Pre-Sale Dividend

Under Portuguese tax law there are no specific rules for the distribution of a pre-sale dividend. Nevertheless, it is, as a general rule, more efficient from a tax perspective for the seller to earn the income on a share deal as a capital than as a dividend, because capital gains on the sale of shares are often exempt from tax.

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 20 percent, which may be reduced under a relevant double-taxation agreement. Notwithstanding, the Portuguese CIT Code, there is a WHT exemption for dividends under the European Union (EU) Parent-Subsidiary Directive, provided the parent company has held a minimum of 10 percent of the share capital of the Portuguese affiliate for a minimum of one year.

The Portuguese CIT Code stipulates that no CIT will be due at the level of the beneficiary company on dividends received from a Portuguese or EU-resident affiliate (qualifying for the Parent-Subsidiary Directive), provided that such affiliate is subject to tax, and the parent company is not transparent for tax purposes and has held a minimum of 10 percent of the share capital of the affiliate (or an acquisition value not lower than EUR 20 million) for a minimum of one year.

Transfer Taxes

Although real estate transfer tax is not due on a share deal as a general rule, the Portuguese Real Estate Transfer Tax Code states that the acquisition of a private limited liability company (Lda.) – that means acquiring more than 75 percent of the share capital of the target company – is subject to real estate transfer tax.

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

- the property tax value; or
- 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 8 percent (normally 6.5 percent).

Note that 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:

- Portugal holding company
- Foreign parent company
- Non-resident intermediate holding company
- Portugal 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 (an S.A. or an 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 as a regular company.

Participation Exemption Regime

Dividends distributed to an SGPS by Portuguese-resident subsidiaries are not taxable, regardless of the level of share capital participation held by the SGPS, provided the participation is held, or there is a commitment to hold it, for no less than one year.

Withholding Tax

Dividends distributed to an SGPS are exempt from WHT, provided the share capital participation is held for no less than one year and represents at least 10 percent of the voting capital.

Exemption on Capital Gains

Capital gains obtained by an SGPS on the disposal of shares held for a period of at least one year are exempt

from corporate income tax. However, capital losses and financial costs associated with the funding for the acquisition of shares are not deductible for tax purposes.

The minimum holding period for the capital gains exemption is extended to three years when:

- the share capital participation was acquired from a related party, from an entity resident in a tax haven jurisdiction or from a Portuguese-resident entity subject to a special taxation regime; or
- the legal status of the seller changed in the three-year period prior to the sale and the taxation regime applicable to the seller under the previous legal status did not entitle it to benefit from such tax exemption on capital gains.

Foreign Parent Company

When 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 the differences in the double taxation agreements signed by Portugal with other countries, there are significant differences in the applicable tax treatment depending on whether the parent company is located in or outside the EU.

In the case of an EU-resident parent company, in addition to the possibility of applying for the reduced WHT rates agreed in the existing double taxation agreements, the parent company may also benefit from WHT exemption on dividends, as explained in Pre-Sale Dividend.

On the other hand, a non-EU resident parent company may benefit from reduced WHT rates only if the corresponding country has signed a double taxation agreement with Portugal.

With regards to capital gains, and although, as a general rule, the double taxation agreements signed by Portugal do not entitle Portugal to tax the capital gains, a foreign parent company (EU-resident or not) may benefit from an exemption on capital gains obtained from the sale of share capital participations in Portuguese-resident companies unless:

- the parent company is owned, directly or indirectly, 25 percent or more by a Portuguese tax-resident entity;

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

Non-Resident Intermediate Holding Company

Similar situation to for a foreign parent company.

Local Branch

A branch of a foreign company is subject to Portuguese CIT on its attributable income at the rate of 12.5 percent of taxable income up to EUR 12,500 and at a rate of 25 percent on taxable income over EUR 12,500. 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 26.5 percent. There is no WHT on distributions to the foreign head office.

A disadvantage, in a commercial sense, of the use 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, depending on the circumstances, may deny the deduction of interest charged or allocated to the branch by the head office.

Under Portuguese tax law profit distributions to, and their receipt by, a permanent establishment of an EU parent company located in Portugal have the same treatment as that applying between a subsidiary and its EU parent.

Joint Ventures

As a general rule, joint ventures are set up as regular Portuguese companies held by the joint venture partners.

Choice of Acquisition Funding

Funding is a critical matter within a transaction. The appropriate mix between debt and equity and the different types of debt may have a significant tax impact under Portuguese law.

In the following paragraphs we will summarize these impacts.

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 tax saving thereby achieved.

Thin-Capitalization

Portuguese tax legislation provides that whenever the indebtedness of a resident entity subject to corporate income tax, to an entity resident outside the European Union with which a special relationship exists is excessive, the interest in relation to the part considered excessive is not deductible for the determination of the taxable income.

A special relationship is deemed to exist when the non-resident entity exercises, directly or indirectly, a significant influence on the management of the Portuguese-resident company. This requirement is deemed to be met, for example, if an entity and/or family members hold, directly or indirectly, a participation of at least 10 percent of the share capital of another company, or if the development of a business activity is significantly dependent on another entity.

The thin-capitalization rules also apply when the Portuguese entity is indebted to an unrelated, non-resident entity that has been provided with collateral or guarantees by a related non-resident entity.

A normal ratio of indebtedness is defined as 2:1 debt to equity, but this ratio does not apply if the taxpayer can show that a high debt-to-equity ratio is normal in its business sector and the same level of debt financing could have been obtained from non-related parties. This evidence must be included in a tax documentation file (Dossier Fiscal) that the companies must compile on a yearly basis. Interest on excessive debt paid to entities resident in tax haven jurisdictions is never deductible, even if the taxpayer can prove the loan conditions are comparable to those agreed by non-related parties in comparable transactions.

Note that the thin-capitalization rules are confined to excessive debt from related parties resident in states other than EU Member States.

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.

Please refer to Transfer Pricing section later in the chapter 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 one year	0.04 percent (per month or part thereof)
One year or more	0.5 percent per year
Five years or more	0.6 percent per year

Source: KPMG in Portugal, 2009

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, 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, other than SGPS companies, is deductible for tax purposes provided the loan is related to the company's activity and, when granted by related entities, complies with the limitations imposed by the thin-capitalization and the transfer pricing rules.

Withholding Tax on Debt and Methods to Reduce or Eliminate

WHT on interest applies at a rate of 20 percent, which may be reduced in accordance with the double taxation agreements signed by Portugal 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.

Portugal is entitled to a transitional period for applying the Interest and Royalties Directive, during which the WHT on interest was 10 percent until 1 July 2009; will

be 5 percent until 1 July 2013, and will be 0 percent thereafter.

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

Checklist for Debt Funding

- Thin-capitalization rules when the funding is obtained by non-EU resident companies.
- Deductibility, for CIT purposes, of the interest expenses provided that they are deemed indispensable for the generation of taxable income or for the maintenance of the production source.
- Compliance with the transfer pricing rules when the funding operation occurs between related parties.
- WHT on the interest: there are advantages if the entity granting the loan is an EU resident. It is also possible to apply for the reduced WHT rates set out in the Interest and Royalties Directive.
- Stamp duty on any kind of financing: 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 relationship between the lender and borrower, and the repayment period.

Equity

The incorporation of a company and increases in its share capital (other than an SGPS or a venture capital company) are subject to Stamp Duty at the rate of 0.4 percent.

However, among other exemptions, if the share capital increase is made in cash, no Stamp Duty is due.

Dividends

Dividends paid by a Portuguese subsidiary to a non-resident entity are subject to WHT at a flat rate of 20 percent, which may be reduced under the double taxation agreements signed by Portugal.

Under the Parent-Subsidiary Directive no WHT applies, provided certain requirements are met, namely that the parent company has held a minimum of 10 percent of the share capital of the Portuguese affiliate for a minimum of one year.

If 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 is only applicable to operations performed for sound economic reasons (that is, which do not have, as their sole or main purpose, to avoid tax that would otherwise be due).

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

Merger (*fusão*)

- When 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, if 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.
- When 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, if 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.
- When a company transfers all its assets and liabilities to the company holding all the shares representing its share capital.

De-Merger (*cisão*)

- Simple de-merger is an operation 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.
- De-merger/merger is a transaction 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.

- De-merger-dissolution is a transaction whereby a company, upon 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.

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*)

Exchange of shares is an operation whereby a company acquires a share capital participation in another company, that 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, if 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 which, from an organizational point of view, constitute an independent unit; that is, an entity capable of functioning by its own means.

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

Hybrids

The current Portuguese tax law does not include rules for hybrids. As from 1 January 2010, however, the Portuguese General Accepted Accounting Principles will include rules for classifying financing instruments as debt or equity in accordance with their substance. The Portuguese tax law was amended to disregard, for tax purposes, reclassifications made for accounting purposes without, however, stipulating how the income arising from such financing instruments should be treated for tax purposes.

Discounted Securities

The Portuguese tax law sees expenses associated with the issue of discounted securities, such as bonds, as tax deductible provided they are essential for the realization of profits and gains subject to CIT, or for the maintenance of the production source.

Taking into account that discounted securities correspond to non-interest-bearing money market instruments issued at a discount and redeemed at maturity for full face value, the income obtained by the company on the securities' maturity is subject to CIT at a maximum rate of 26.5 percent.

Deferred Settlement

In case of a deferred settlement of the consideration, the acquirer should address to the following issues:

- if the transaction involves related parties interest must be charged over the deferral period to comply with the transfer pricing rules; and
- if the deferral period is significant, there is a risk that the deferred consideration will be deemed 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, de-merger, and contributions in-kind can take place.

It creates a simplified merger regime for situations involving a company wholly-owned by the merging company. This regime has recently 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 respective bureaucratic process.

In this regard, the new Portuguese Generally Accepted Accounting Principles (GAAP) establishes that if 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, the 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 as a merger reserve, and included in an equity account.

Note that the adoption of the IFRS for Portuguese tax purposes has not changed the tax treatment of mergers, de-mergers, contributions in-kind and exchanges of shares.

Group Relief/Consolidation

A qualifying group for the group relief regime consists of a parent company holding a share capital participation of at least 90 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 three 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.

For the regime to apply, the parent company must notify the tax authorities of its adoption. The regime remains valid indefinitely if 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 three years prior to the start of the regime, except if the share capital participation is held by the parent company for more than two 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;
- fulfill the minimum participation requirement indirectly through a non-qualifying company, such as a non-resident company; and
- do not assume the legal form of an Lda. company, an S.A. company, or a 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.

Intra-group 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 will cease to apply whenever a company leaves the tax group and the parent company does not opt for the continuation of the regime for the remaining companies, or if a change occurs in the composition of the group and the parent company does not report the change to the tax authorities.

Furthermore, the regime will cease to apply whenever the tax authorities assess the taxable income of any of the group companies through indirect methods (applied in exceptional cases, when the accounting records of the company are not considered to be reliable).

On termination of the regime, all the tax losses generated while it was in force that were not yet used will be lost.

Transfer Pricing

Portuguese transfer pricing rules are effective for tax periods starting during or after 2002. Under these rules taxpayers must maintain documentation relating to the transfer pricing policy adopted contracts and other legal documents concluded with entities with which they

have special relations. The documentation must also include any changes that occur and information about the related parties, a functional analysis, a financial analysis, and other information that may be considered relevant in determining the terms and conditions that would normally apply between independent entities, to support the transfer pricing method(s) used.

Taxpayers are obliged to indicate, in an annex to the corporate income tax return, the existence or non-existence in the respective tax year of transactions with related entities and must:

- identify the related entities involved;
- identify the value of the transactions realized with each of the related entities; and
- declare if, at the date of the transactions, documentation about the transfer pricing policy adopted existed.

If the transfer pricing rules are not observed with respect to non-resident entities, the taxpayer must make the necessary adjustments when determining the taxable income.

In July 2008 the Portuguese tax authorities released rules for advanced pricing agreements (APAs).

Dual Residency

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

The double taxation agreements signed by Portugal include rules to avoid situations of dual residency. In our experience, 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 establishes that profits obtained by companies resident in tax haven jurisdictions are attributed to their Portuguese resident shareholder regardless of their distribution. For this rule to be applicable, the Portuguese entity must hold, directly or indirectly, a share capital participation of at least 25 percent or 10 percent in case the company located in a tax haven is, directly or indirectly, held in more than 50 percent by Portuguese resident entities.

Comparison of Asset and Share Purchases

Advantages of Asset Purchase

- Possibility 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.
- It 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 (such as goodwill).

- Accounting profits may be affected by the creation of acquisition goodwill.
- The benefit of any tax losses incurred by the target company remains with the vendor.

Advantages of Share Purchase

- May benefit from existing supply or technology contracts.
- Higher flexibility to achieve capital gains exemption for the vendor, thereby reducing the price.
- Not subject to transfer tax in most cases.
- Acquirer 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 the purchase price.
- Less flexibility in funding options.

Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)		
Algeria	15	10 ³	0/15 ⁴	10
Austria	15	15	10	5/10 ⁵
Belgium	15	15	15	10
Brazil	15	10 ³	0/15 ¹³	15
Bulgaria	15	10 ³	0/10 ⁴	10
Canada	15	10 ³	0/10 ⁴	10
Cape Verde	10	10	0/10 ⁴	10
Chile	15	10	5/10/15 ⁶	5/10 ⁷
China (People's Rep.)	10	10	0/10 ¹³	10
Cuba	10	0/5 ¹³	0/10 ⁴	5
Czech Republic	15	10 ³	0/10 ⁴	10
Denmark	10	0 ⁸	0/10 ⁴	10
Estonia	10	10	0/10 ¹³	10
Finland	15	10	15	10
France	15	15	10/12 ¹⁴	5
Germany	15	15	10/15 ⁹	10
Greece	15	15	15	10
Hungary	15	10 ³	0/10 ⁴	10
Iceland	15	10 ³	0/10 ⁴	10
India	15	10 ³	0/10 ⁴	10
Indonesia	10	10	0/10 ¹³	10
Ireland	15	15	0/15 ⁴	10
Israel	15	5	0/10 ¹³	10
Italy	15	15	0/15 ⁴	12
Korea (Rep.)	15	10 ³	0/15 ⁴	10
Latvia	10	10	0/10 ¹³	10
Lithuania	10	10	0/10 ¹³	10
Luxembourg ¹⁰	15	15	10/15 ¹¹	10
Macau	10	10	0/10 ⁴	10
Malta	15	10 ³	0/10 ¹³	10
Mexico	10	10	0/10 ⁴	10
Morocco	15	10 ³	12	10
Mozambique	15	15	0/10 ⁴	10
Netherlands	10	0 ⁸	0/10 ⁴	10 ¹⁵
Norway	15	10	15	10
Pakistan	15	10 ³	0/10 ⁴	10
Poland	15	10 ³	0/10 ⁴	10
Romania	15	10 ³	0/10 ⁴	10
Russia	15	10 ³	0/10 ⁴	10
Singapore	10	0/10 ¹³	0/10 ⁴	10
Slovak Republic	15	10 ³	10	10
Slovenia	15	5	0/10 ¹³	5
South Africa	15	10 ³	0/10 ¹³	10
Spain	15	10	15	5
Sweden	10	0 ⁸	0/10 ⁴	10
Switzerland	15	10	10	5
Tunisia	15	15	15	10
Turkey	15	5 ³	0/10/15 ^{12and13}	10
Ukraine	15	10 ³	0/10 ⁴	10
United Kingdom	15	10	10	5
United States	15	5 ³	0/10 ⁴	10
Venezuela	10	10	0/10 ⁴	10/12 ¹⁶

Notes

1. Many treaties provide for an exemption for certain types of interest, such as 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 otherwise indicated, a 25-percent capital holding is required for the reduced rates.
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 two 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 on bonds or securities regularly and substantially traded on a recognized securities market; the 10-percent rate applies to interest from loans granted by banks and insurance companies, and to interest from sales on credit.
7. The lower rate applies to royalties from the use of, or right to use, any industrial, commercial, or scientific equipment.
8. Under this treaty, the exemption applies to dividends qualifying for the EC Parent-Subsidiary Directive.
9. 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 to Portugal.
10. The treaty does not apply to exempt Luxembourg holding companies.
11. The rate is 10 percent for interest that is paid to a Luxembourg financial establishment and is a deductible expense for the Portuguese company.
12. The lower rate applies to interest paid on a loan made for a period of more than two years.
13. The zero rate applies to interest paid to the government of the other state or to any other public bodies.
14. The rate is 10 percent for interest deriving from bonds.
15. Under this treaty, the withholding tax rates to be applied correspond to the ones set out in the EC Interest and Royalties Directive, if applicable.
16. The rate is 10 percent for royalties regarding technical assistance services.

KPMG in Portugal

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