

TAXATION OF DIVIDENDS

DISTRIBUTED BY PORTUGUESE RESIDENT COMPANIES SUBJECT TO CORPORATE TAX

Since we are in the season for the distribution of dividends, it is not without use to review and update, our last charter on this issue.

It shall be recalled that in 2005 the Portuguese tax system streamlined its rules for the taxation of dividends, by harmonising rates which previously varied in accordance to the nature of the recipient of the dividends. This, along with the introduction of some provisions aimed at dealing with schemes that used exempt entities to evade tax, helped to turn the taxation of dividends more coherent and simple.

We will outline here the basic features of the current system for taxation of dividends distributed by Portuguese resident companies. Further below, more details can be found on a table and some notes therein included.

A different tax treatment that may stem from the application of the Madeira Free Trade Zone regime was not considered, nor was it considered the special case of companies resident in the Switzerland.

Pursuant to the parent-subsidiary directive – directive 90/435/EEC - Portugal exempts from taxation, subject to certain conditions, dividends earned by legal entities, mainly companies, located in the EU territory. Double taxation is effectively eliminated in these situations.

Otherwise, only 50% of the earned dividends earned by resident individual or companies are exempted from taxation. As an alternative, the resident individual (but not the resident company) may opt for the application of a 20% flat rate applicable to 100% of the received dividend (the maximum rate being 42%, currently, applicable to the aggregated income exceeding € 61.260).

Non-resident individuals (and non-resident companies without a permanent establishment in Portugal, not benefiting from the application of the parent-subsidiary directive) are subject to taxation on dividends received from Portuguese resident companies, at a rate of 20%.

Accordingly, in the negotiation of tax treaties as well as in EU negotiations, Portugal tries, as a rule, to preserve the source country power to tax dividends. In the negotiation of tax treaties, Portugal follows the OECD Model Convention as regards dividends, for it is deemed protective enough of the source country interests.

TAXATION OF DIVIDENDSⁱ

	Resident or non-resident with a permanent establishment in Portugal to which the dividends can be attributed	Resident in a European Union country (without a permanent establishment in Portugal to which the dividends can be attributed)	Resident in a country with which Portugal has entered into a double taxation treaty (DTT) (without a permanent establishment in Portugal to which the dividends can be attributed)	Resident in other countries (without a permanent establishment in Portugal to which the dividends can be attributed)
Individuals who did not obtain the dividends as part of a business or professional activity	If the income is aggregated by option of the holder – 20% withholding tax deemed to represent payment on account of the final tax due (the final amount will depend on the rate determined for the total of the aggregated income relating to the year in question) levied on only 50% of the dividends ⁱⁱ ; If the income is not aggregated – 20% withholding tax (the definitive amount) levied on the entire amount of the dividends.	20% withholding tax (the definitive amount) levied on the entire amount of the dividends (there is no option to aggregate the income in this case).	The relevant DTT (depending on which country the beneficiary of the dividend resides in) must be consulted to ascertain the applicable rate of withholding tax which will not currently exceed 15%; Proof must be presented to the entity which will carry out the distribution of the dividends of the residence in the country in question, using the form provided by the Tax Authorities ⁱⁱⁱ	20% withholding tax (the definitive amount) levied on the entire amount of the dividends (there is no option to aggregate the income in this case).
Other individuals (who obtained the dividend as part of a business or professional activity)	20% withholding tax (the definitive amount) levied on the entire amount of the dividends (there is no option to aggregate the income in this case ^{iv}).	20% withholding tax (the definitive amount) levied on the entire amount of the dividends (there is no option to aggregate the income in this case).	The relevant DTT (depending on which country the beneficiary of the dividend resides in) must be consulted to ascertain the applicable rate of withholding tax which will not currently exceed 15%; Proof must be presented to the entity which will carry out the distribution of the dividends of the residence in the country in question, using the form provided by the Tax Authorities ^v	20% withholding tax (the definitive amount) levied on the entire amount of the dividends (there is no option to aggregate the income in this case).
Companies, cooperatives and public companies^{vi} and permanent establishments of companies resident in the EU (who satisfy the conditions set out in Article 2 of EC Directive 90/435/EEC)	20% withholding tax deemed to represent payment on account of the final tax due ^{vii} ; final tax levied on only 50% of the dividends; No withholding tax and dividends exempted from taxation ^{viii} in cases where the holding is at least of 10% (or the cost of acquisition is not less than €20,000,000) and is maintained for an uninterrupted period of at least one year ^{ix} (by an entity to whom Article 6 of the Corporation Tax (IRC) Code does not apply). In the case of a permanent establishment this regime only applies if the entity satisfies the requirements and conditions of Article 2 of EC Directive 90/435/EEC)	20% withholding tax (the definitive amount) levied on the entire amount of the dividends; No withholding tax (tax exemption) in cases where a holding of not less than 15% is maintained for an uninterrupted period of at least two years by a company that meets the requirements of Article 2 of EC Directive 90/435/EEC ^x	The relevant DTT (depending on which country the beneficiary of the dividend resides in) must be consulted to ascertain the applicable rate of withholding tax which will not currently exceed 15% but can be limited to 5% in cases where there is a qualified holding (substantial holding ^{xi}); Proof must be presented to the entity which will carry out the distribution of the dividends of the residence in the country in question, using the form provided by the tax authorities ^{xii}	20% withholding tax (the definitive amount) levied on the entire amount of the dividends

	Resident or non-resident with a permanent establishment in Portugal to which the dividends can be attributed	Resident in a European Union country (without a permanent establishment in Portugal to which the dividends can be attributed)	Resident in a country with which Portugal has entered into a double taxation treaty (DTT) (without a permanent establishment in Portugal to which the dividends can be attributed)	Resident in other countries (without a permanent establishment in Portugal to which the dividends can be attributed)
IRC taxable entities whose main activity is not commercial, industrial or agricultural (whose main activity is not a business activity)^{xiii}	20% withholding tax deemed to represent payment on account of the final tax due; final tax levied on only 50% of the dividends	20% withholding tax (the definitive amount) levied on the entire amount of the dividends; No withholding tax (tax exemption) in cases where a holding of not less than 15% is maintained for an uninterrupted period of at least two years by a company that meets the requirements of Article 2 of EC Directive 90/435/EEC ^{xiv}	The relevant DTT (depending on which country the beneficiary of the dividend resides in) must be consulted to ascertain the applicable rate of withholding tax which will not currently exceed 15% but can be limited to 5% in cases where there is a qualified holding (substantial holding ^{xv}); Proof must be presented to the entity which will carry out the distribution of the dividends of the residence in the country in question, using the form provided by the Tax Authorities ^{xii}	20% withholding tax (the definitive amount) levied on the entire amount of the dividends
IRC taxable entities exempt from tax on investment income^{xvii}	No withholding tax (tax exemption), where proof of exemption is presented prior to the date on which the withholding tax is to be levied; Taxation at the rate of 20% where the shareholding was not held during the year before the date on which the dividends were distributed and a one-year holding period is not completed afterwards.	No withholding tax (tax exemption), where proof of exemption is presented prior to the date on which the withholding tax is to be levied; Taxation at the rate of 20% where the shareholding was not held during the year before the date on which the dividends were distributed and a one-year holding period is not completed afterwards.	No withholding tax (tax exemption), where proof of exemption is presented prior to the date on which the withholding tax is to be levied; Taxation at the rate of 20% where the shareholding was not held during the year before the date on which the dividends were distributed and a one-year holding period is not completed afterwards.	No withholding tax (tax exemption), where proof of exemption is presented prior to the date on which the withholding tax is to be levied; Taxation at the rate of 20% where the shareholding was not held during the year before the date on which the dividends were distributed and a one-year holding period is not completed afterwards.
Property and Securities Investment Funds and Funds of Funds, which are created and operating in accordance with Portuguese law	20% withholding tax (without prejudice to a possible lessening of the double taxation at the level of the holders of the fund participation units, but not at the level of the fund itself).			

¹This table contains general information only and does not dispense with the need to obtain professional advice, nor does it take into account the possibility that anti-tax abuse measures may apply; the information is as available at 12.04.2007.

²By definition this does not include the permanent establishment of non resident individuals, as the permanent establishment, for purposes of personal income tax (IRS) implies engaging in a business or professional activity; if these were included here, the regime of taxation of only 50% of the dividends, which under the IRS Code only benefits resident individuals, would not apply.

³If the proof is not presented in good time and as required by law, tax will be levied at 20% with the beneficiary being entitled to apply for a refund of the amount corresponding to the difference between this rate and the maximum rate authorised by the relevant DTT.

⁴In cases where the dividend is attributed to a permanent establishment in Portugal of a non resident, it is arguable given the existing tax framework, that the tax regime is as follows: 20% withholding tax deemed to represent payment on account of the final tax due (final rate of 25% on the income of this permanent establishment, including the dividends); this alternative interpretation, however, seems incompatible with the general regime provided for in the IRS Code for the taxation of investment income.

⁵If the proof is not presented as required by law, tax will be levied at 20% with the beneficiary being entitled to apply for a refund of the amount corresponding to difference between this rate and the maximum rate authorised by the relevant DTT. ⁶On the assumption – which in the majority of cases will be correct – that the main activity is commercial, industrial or agricultural (business activities in general). Note that for non-residents who do not have a permanent establishment in this country to which the dividends can be attributed, the regime described in the fourth column (and in many cases in the third column) apply, regardless of the type of entity involved as long as it is not subject to IRS tax.

⁷Except when, under Articles 9 and 10 of the IRC Code or in the situations provided for in the Tax Benefits Statute, all or part of the investment income is excluded from the IRC exemption therein provided for; in these cases the withholding tax represents the definitive amount of tax due.

⁸The exclusion of dividends from taxation applies regardless of the percentage of the holding and the period of time it is maintained, in the case of dividends stemming from holdings in which the technical reserves of insurance companies and of insurance mutualities have been applied, and also in the case of dividends stemming from holdings of "regional development companies", "investment companies" and "financial brokerage companies". Holding companies (under the SGPS regime) also benefit from exclusion of taxation of the dividends received regardless of the percentage or value of the holding (but continue to be subject to the requirement of maintaining the holding during an uninterrupted period of one year).

⁹The exclusion from taxation operates even if the one-year holding period has not elapsed at the date of distribution. But if this period is not completed afterwards, the dividend will then become subject to tax; with regard to withholding, in order for its exclusion to apply it is always necessary that the one-year holding period have elapsed at the time the dividends are distributed.

¹⁰In order for no withholding tax to be levied the beneficiary of the dividend must ensure that he provides the proof of the requirements on which the exemption is conditional in good time and in the manner prescribed by law. If he does not, he will have to apply for a refund of the tax withheld. This is in fact the only possible way when the two-year holding period is only completed after the date on which the dividends are distributed.

¹¹It is necessary to determine previously whether the exemption regime described in the second part of the previous column applies.

¹²If the proof is not presented in accordance with the legal requirements, 20% tax will be levied, and the beneficiary of the income can later apply for a refund of the amount corresponding to the different between this rate and the maximum rate authorised by the DTT.

¹³Including companies, cooperatives and public companies (whose main activity is not commercial, industrial or agricultural). Note that for non-residents who do not have a permanent establishment in Portugal to which the dividends can be attributed, the regime described in the fourth column (and in many cases in the third column) apply, regardless of the type of entity involved as long as it is not subject to IRS tax.

¹⁴In order for no withholding tax to be levied the beneficiary of the dividend must ensure that he provides the proof of the requirements on which the exemption is conditional in good time and in the manner prescribed by law. If he does not, he will have to apply for a refund of the tax withheld. This is in fact the only possible way when the two-year holding period is only completed after the date on which the dividends are distributed.

¹⁵It is necessary to determine previously whether the exemption regime described in the second part of the previous column applies.

¹⁶If the proof is not presented as required by law, tax will be levied at 20% with the beneficiary being entitled to apply for a refund of the amount corresponding to the difference between this rate and the maximum rate authorised by the relevant DTT.

¹⁷Includes any type of entity including those included in the previous two rows when they benefit from the exemption; risk capital funds, pension funds, savings-retirement funds, savings-education funds and savings-retirement/education funds created and operating in accordance with the Portuguese legislation can be given as an example.

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