

Understanding Double Taxation Treaties in Portugal: A Technical Guide

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By **Lionel de Freitas**, 21st October 2024

Portugal has established itself as a prime destination for businesses seeking a strategic base within Europe. One of the key factors contributing to its appeal is its extensive network of Double Taxation Treaties (DTTs). These treaties, which Portugal has signed with over 80 countries, play a crucial role in eliminating or minimising the risk of double taxation on income and profits, thereby fostering cross-border trade and investment.

In this note, we will give a general overview into some of the aspects of Portugal's double tax treaties, exploring some of its benefits, and how they can be utilised by businesses and individuals.

The Structure of a Double Taxation Treaty (DTT)

A typical Double Taxation Treaty follows the Organisation for Economic Co-operation and Development (OECD) Model Convention, though countries may negotiate specific provisions based on their unique circumstances. Portugal's DTTs generally adhere to this model, which outlines how income is taxed depending on its type (e.g., dividends, interest, royalties, business profits) and where it is earned.

Some of the key elements of Portugal's DTTs include:

- **Residence and Source Principles:** Portugal's treaties distinguish between individual tax residents (those who are subject to tax on their worldwide income) and individual non-tax residents (who are taxed only on some of the Portuguese-sourced income). The treaties help clarify which country

has taxing rights over specific types of income.

- **Permanent Establishment (PE):** The concept of a permanent establishment is central to DTTs. In general, if a business has a significant and ongoing presence in Portugal, it may create a permanent establishment, giving Portugal the right to tax the business's income attributable to that establishment. DTTs provide detailed guidelines on what constitutes a PE and how profits from the PE are taxed.

- **Elimination of Double Taxation Methods:** Portugal's DTTs typically employ either the exemption method or the credit method to eliminate double taxation in a scenario of a corporation:
 - **Exemption Method:** Income taxed in the foreign country is exempt from Portuguese tax.

 - **Credit Method:** Taxes paid in the foreign country are credited against Portuguese tax liability.

Specific Provisions in Portugal's Double Taxation Treaties

1. Dividends, Interest, and Royalties

One of the most significant benefits of DTTs for companies is the reduction in withholding tax rates on dividends, interest, and royalties paid to residents of the treaty partner country. Without a DTT, these payments might be subject to high withholding taxes in the source country.

- **Dividends:** Portugal generally imposes a 28% withholding tax on dividends paid to individuals who are non-resident in Portugal, but under many of its DTTs, this rate is reduced. For example, the withholding tax rate on dividends paid to individual shareholders in treaty countries can be as low as 5% to 15%, depending on the stake in the paying company. Under specific conditions, shareholders may be exempt from withholding tax.

- **Interest:** Portugal's domestic withholding tax rate on interest paid to non-residents is also 28%. However, under a DTT, this rate can be significantly

reduced, often to 10% or even 5% in some cases.

- **Royalties:** Royalties paid to foreign entities are typically subject to a 28% withholding tax, but this can be reduced to as low as 5% to 15% under certain treaties.

Each treaty will specify the applicable rates, and businesses and individuals should review the provisions of the relevant treaty to understand the exact reductions available.

2. Business Profits and Permanent Establishment

A crucial aspect of DTTs is determining how and where business profits are taxed. Under Portugal's treaties, business profits are generally only taxable in the country where the business is based, unless the company operates through a permanent establishment in the other country.

A permanent establishment can take various forms, such as:

- A place of management,
- A branch,
- An office,
- A factory or workshop,
- A construction site lasting more than a specified period (typically 6-12 months, depending on the treaty).

Once a permanent establishment is deemed to exist, Portugal gains the right to tax the profits attributable to that establishment. However, the treaty ensures that only the profits directly related to the permanent establishment are taxed, while the rest of the company's global income remains taxed in its home country.

3. Capital Gains

Capital gains are another area covered by Portugal's Double Tax Treaties. Under most DTTs, capital gains derived from the sale of immovable property (such as real estate) are taxed in the country where the property is located. Gains from the sale of shares in real estate-rich companies may also be taxed in the country where the property is situated.

For gains on the sale of other types of assets, such as shares in non-real estate companies or movable assets, the treaties often assign taxation rights to the country where the seller is resident, though exceptions can exist depending on the specific treaty.

4. Income from Employment

Portugal's treaties follow the OECD model in determining how employment income is taxed. Generally, the income of a resident of one country who is employed in another country is taxable only in the country of residence, provided:

- The individual is present in the other country for less than 183 days in a 12-month period.

- The employer is not a resident of the other country.

- The remuneration is not paid by a permanent establishment in the other country.

If these conditions are not met, the employment income may be taxed in the country where the company is based. This provision is particularly relevant for expatriates working in Portugal or Portuguese employees working abroad.

In these situations, the foreign company will have to request a Portuguese tax number to fulfil with its tax obligations in Portugal.

How Double Tax Treaties Eliminate Double Taxation

As mentioned earlier, Portugal uses two primary methods to eliminate double taxation: the exemption method and the credit method.

- **Exemption Method:** Under this method, foreign-sourced income may be exempt from tax in Portugal. For instance, if a Portuguese resident earns income from a country with which Portugal has a DTT and under internal Portuguese tax rules the exemption method may be applied, and that income may not be taxed in Portugal at all.
- **Credit Method:** In this case, income earned abroad is taxed in Portugal, but the tax paid in the foreign country is credited against the Portuguese tax liability. For example, if a Portuguese resident earns income in the United States and pays tax there, they can deduct the amount of U.S. tax paid from their Portuguese tax liability on that income.

Key Countries with Double Tax Treaties with Portugal

Some of Portugal's most significant Double Taxation Treaties include those with:

- **United States:** Reduced withholding taxes on dividends (15%), interest (10%), and royalties (10%). Employment income and business profits are taxed based on the presence of a permanent establishment.
- **United Kingdom:** Similar reductions in withholding taxes and clear guidelines for the taxation of pensions, employment income, and capital gains.
- **Brazil:** As a major trading partner, this treaty reduces tax barriers for cross-border investments, with special provisions for dividends and interest payments.
- **China:** Facilitates trade between the two countries by reducing withholding tax rates and providing clear rules for taxation of business profits and investment income.

How Can Dixcart Portugal Can Assist?

At Dixcart Portugal we have a wealth of experience in helping businesses and individuals optimise their tax structures using Portugal's Double Tax Treaties. We offer specialised advice on how to minimise tax liabilities, ensure compliance with treaty provisions, and navigate complex international tax scenarios.

Our services include:

- Assessing the availability of reduced withholding taxes on cross-border payments.
- Advising on the establishment of permanent establishments and the related tax implications.
- Structuring business activities to take full advantage of treaty benefits.
- Providing support with tax filings and documentation to claim treaty benefits.

Conclusion

Portugal's network of Double Taxation Treaties offer significant opportunities for businesses and individuals engaged in cross-border operations. By understanding the technical details of these treaties and how they apply to specific situations, companies can greatly reduce their tax liabilities and enhance their overall profitability.

At Dixcart Portugal, we are experts in leveraging these treaties to benefit our clients. If you are looking to start a business in Portugal or need expert advice on international tax strategies, we provide the support you need to simplify the process and position your business for success. Please contact Dixcart Portugal for more information advice.portugal@dixcart.com.