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Real Estate Going Global
Portugal

Tax and legal aspects of real estate investments around the globe

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All information used in this content, unless otherwise stated, is up to date as of 24 July 2018.

Real Estate Tax Summary – Portugal

Understanding the basic principles

Legal environment

Definition of real estate activities

For legal purposes, the definition of real estate promotor is included in Law No 68/04 of 25 March, and is defined as any person, individual or legal, private or public, who directly or indirectly decides, promotes, schedules and finances with its own or other resources, the building constructions or reconstructions destined for housing to be enjoyed by itself, or to be sold or leased.

The definition of real estate lessor is the person, individual or entity that leases urban real estate.

Investors acquiring property via a corporate structure are subject to a beneficial owner register, in compliance with Law no 83/2017, of 8 August, setting out anti-money laundering and anti-terrorism financing measures.

In addition, and again aiming at complying with the abovementioned legislation, the ultimate beneficial owner(s) of the corporate structure may be: (i) physical person(s) who is/are directly or indirectly owner(s) of stockholdings representing more than 25% of the company share capital; (ii) physical person(s) that by means of an agreement, including without limitation a shareholders' agreement, hold(s) more than half of the voting rights at the general meeting of the company or the right to appoint more than half of the company's board of directors; or (iii) if none of the two foregoing circumstances are applicable, the director(s) of the company.

Please note that Lawyers and Notary Publics are bound to a communication obligation to the relevant bar association when they suspect of an illegal source of financing when handling a client´s legal situation. Also, and to the extent of preventing money-laundering activities, payments above €3,000 cannot be made in cash.

The property right

The property right is set forth in the Constitution of the Portuguese Republic and generally no one can be deprived of their property, except in cases of public utility and always subject to a compensation.

This is an exclusive and complete right to possess, enjoy and dispose of an interest in property. In order to create a more than merely contractual right and to ensure interest in real estate vis-à-vis third parties, real estate must be registered before the Land Registry Office.

The surface right (*direito de superfície*)

A surface right is defined in the civil code as the right to build and maintain a building, or use and enjoy a building situated on or over land which is owned by a third party. The right can be established for a limited period of time or be granted in perpetuity. In

order to have effect vis-â-vis third parties, registration in the Land Registry Office is required.

Construction right

According to the "*Lei de Bases Gerais da Política Pública dos Solos, de Ordenamento do Território e de Urbanismo*", Law no 31/2014 of 30 May, the owner of a plot has the right to construct. However, the owner must obtain specific licenses, and be aware of having to comply with several compulsory rules, failing which the ultimate sanction could be the demolition of the construction.

Usufruct right and other figures of divided property

Usufruct is contemplated in the Portuguese civil code and consists of a right to use and enjoy a third party's property for a certain period of time, for the life of the beneficiary. In the event that the beneficiary is a legal person it is limited to a period of 30 years. In order to have effect vis-â-vis third parties, registration in the Land Registry Office is required.

Regarding other figures of divided property ("*Direitos reais de gozo*"), the regime of community of owners of a building which is legally and physically divided into several units (condominium) is worthy of mention.

The incorporation of a property into this regime must be made by means of a public deed or an authenticated document and typically will occur at the same time the condominium regulations. The incorporation title of the condominium ("*Título constitutivo da propriedade horizontal*") contain the terms and conditions for the use of the common areas and sets out the rules for the management of the property.

Additionally, it contains a formula to determine the amount attributable to each unit for maintenance of the common parts of the property, services and common costs. The incorporation title of the condominium must be duly registered in the Land Registry Office.

Another form of divided property is the joint-ownership over the same property between two or more owners. A co-owner may have a bigger quota over the property, nonetheless his rights and obligations remain equal when compared to a co-owner with a lower quota. Co-owners may divide the property and that division can be executed by agreement or according to procedure law.

Finally, time-sharing ("*Direito real de habitação periódica*") should be mentioned. This right refers to property related to tourism and the hospitality industry and it is granted temporally (usually one week per year).

Restrictions on ownership by foreigners

There are no restrictions on Foreigners owning property in Portugal. Actually, Portugal has been undertaking a series of measures to attract new and foreign investment to the country. Namely, through the establishment of a residency permit program (commonly referred to as "Golden Visas") and a more favourable tax regime, when compared to other EU Member States.

Lease agreements

Lease agreements are specifically included in the civil code, which distinguishes between urban leases and rural leases. With respect to urban leases, it may be distinguished between residential and non-residential urban leases.

It is relevant to point out that, under Portuguese law, the maximum initial lease length is 30 years.

Also, and unless parties agree otherwise, in order to sublease property the landlord's prior written consent is mandatory, otherwise the landlord may terminate the contract based on tenant's default.

Administrative concessions

This type of contract is regulated in the Public Contracts Law and is divided into concession of public services or public works.

Concession of Public Services is defined as a contract in which the concessioner has the obligation to manage at his own risk a certain public service activity, and obtain the profits that result from the activity.

Concession of Public Works can be defined as the contract in which the concessioner has the obligation to execute a public work and the respective right to exploit, for a certain period of time.

Town planning regulations

Zoning and planning is mainly governed by a planning policy foreseen by Decree Law no. 80/2015, of 14 May 2015.

All plans bind public entities and private individuals are subject to special and municipal plans.

The relevant urban plan sets forth whether the real estate owner may construct a new building or restore the existing one. The construction rules are set out by building regulations including the General Regulations of Urban Buildings (*Regulamento Geral das Edificações Urbanas*, from 1951).

Municipal plans establish the allowed use according to the sector (housing, commerce and services, industry, agriculture, etc.).

The main relevant authorities in what regards town planning regulations are the municipalities. These local public bodies are responsible for the draw and approval of the municipal plans for land and zoning and to evaluate the compliance of any project with the municipal regulations.

The performance of works aiming to the construction of a new building or significant alterations to an existing one is subject to licensing.

If intended, it is possible to file a prior information request in order to obtain an official statement on the feasibility of the project.

Finally, the use of properties is, by principle, subject to a Municipal Use Permit.

Tax environment

General

Corporate and individual investors planning to invest in real estate located in Portugal may opt between indirect acquisition (ie, through investment vehicles), or direct acquisition.

Rental income

Resident companies and branches, ie, permanent establishments (PEs) of non-resident companies, when obtaining net rental income, they are taxed at the main Corporate Income Tax (CIT) rate of 21%, plus a local surtax (*derrama municipal),* which is levied by several municipalities in Portugal, of up to 1.5% of taxable profit, not considering any tax losses carry forward.

State surtax (*derrama estadual*) also accrues as follows: (i) 3% for taxable profit between €1.5m and €7.5m; (ii) 5% for taxable profit above €7.5m and up to €35m; and (iii) 9% for taxable profit above €35m.

Resident companies and branches are allowed to deduct interest, depreciation charges and other property expenses such as taxes and duties paid. Taxation is levied on an accrual basis.

Non-resident companies carrying out passive investments, in general, are not deemed to have a PE in Portugal. Net rental income, determined on a cash basis, will be taxed at the income tax rate of 25%. They are allowed to deduct expenses effectively incurred, paid and properly documented, in order to obtain rental income. Interest, depreciation charges, furniture, household appliances, decoration and comfort accessories cannot be deducted.

Depreciation

According to the local GAAP, which follows the IFRS rules, real estate classified as an investment property can be valued under the cost model or fair value model. The option for one or the other model may result in different financial and tax results.

In case the company opts for booking the investment property at cost, it should be depreciated for tax purposes, at a 2% annual rate for flats or apartments, offices and commercial property and at a 5% annual rate for industrial buildings or hotels. Depreciation is calculated under the straight-line method.

Land cannot be depreciated for tax purposes.

The property should also be subject to an impairment test and, if any loss is accounted for, its acceptance for tax purposes is subject to the fulfilment of strict tax exceptional devaluation requirements.

If any impairment loss related to the property is recognised and not deductible for tax purposes in the year on which it is accounted for, considering that it is an asset that is subject to depreciation, the impairment's tax deductibility would be deferred for the remaining useful life of the property, meaning, the respective amount will be eventually recovered for CIT purposes.

No accounting depreciation charge is allowed in case the company opts for booking the investment property at fair value. Nevertheless, for tax purposes, investment property valued at fair value may be tax depreciated throughout the maximum period of its useful lifetime (ie, 100 years), at a rate of 1% per annum. The basis for tax depreciation corresponds to the acquisition/construction cost, disregarding any fair value variations.

Capital gains on the sale of property

Capital gains arising on the sale of property by tax resident companies and PEs of non-resident companies are subject to the main CIT, at the rate of 21%. The final tax rate for a company may increase if local and state surtaxes are levied.

Reinvestment relief mechanism is not available in the case of investment property.

Any capital gain arising from the sale of property located in Portugal when owned by a non-resident entity without PE in Portugal is taxable at a rate of 25%.

Additionally, capital gains shall be liable to tax in Portugal, whenever they result from the transfer of share capital or similar rights in any entity (non-resident in Portuguese territory), when, in any given time in the past 365 days, the value of those shares or rights result, directly or indirectly, in more than 50% of immovable property or rights in rem over immovable properties located in the Portuguese territory (except if related to agricultural, industrial and commercial activity and not the sale and purchase of immovable property).

Loss carry forward

The carry forward period for tax losses generated in 2013 was 5 years. From 2014 to 2016, tax losses can be carried forward for 12 years. For tax losses generated in 2017 onwards the carry forward period will be 5 years. Losses can be used to offset net operating income and capital gains realised on the sale of property located in Portugal.

The deduction of tax losses is limited to 70% of the taxable profit of the year, with the possibility of carrying forward the remaining 30% in future years within the established carry forward period (12 or 5 years).

Nevertheless, the company loses the right to keep on carrying forward the tax losses in the year when there is a change of more than 50% of the share capital or the majority of the voting rights of the company. Mere company reorganisations within the same group are not considered changes of ownership of share capital for the purposes of this rule.

The Portuguese Tax Administration may nevertheless authorise upon a request submitted by the company within 30 days upon the transfer of the shares.

Real Estate Investments – Portugal

Direct investments in Portuguese property

Corporate and individual investors planning to invest in property located in Portugal may choose from various different methods to structure such an investment. Basically, they can opt between a direct or indirect acquisition, ie, through the purchase of shares in a company owning property in Portugal purchase of units in Collective Investment Vehicles. The main tax issues arising from direct investments are addressed in this section.

General

Companies and individuals wishing to invest in Portuguese property may opt for a direct purchase of the property.

Given the fact that tax liabilities regarding property taxes may follow the property, it is generally advisable to conduct a tax due diligence review on the target property. In such due diligence, property taxes and charges and VAT status should be checked.
If necessary, the seller should be asked for certain guarantees on possible tax liabilities.

Legal aspects

Promissory sale and purchase agreement, purchase option, unilateral promise to sell/buy

Promissory sale and purchase agreement, and purchase options or the unilateral promises to sell/buy, can be executed before a notary public or, alternatively, privately between parties. It can be recorded at the Land Registry Office.

Purchase option

Under a purchase option agreement, the seller, referred to as a promisor, undertakes during a certain term, the obligation to sell the property (object of the contract) to the other party, the beneficiary, on the date when the beneficiary gives notice of its will to buy said property.

The fact of the beneficiary signing the promise and consequently accepting it, does not bind him to buy the property. If the beneficiary exercises the option to buy up until the agreed term, the sale is completed. If not, then the seller is free to sell the property to a third party.

In order to enforce this Purchase option vis-à-vis third parties the purchase option must be registered before the Land Registry Office.

Promise to sell/buy

This type of agreement entails an obligation to sell and an obligation to buy implying a reciprocal undertaking, consequentely it is possible to claim the performance (execução específica) of the abovementioned agreement before a court.

Tax aspects

Depending on the status of the owner of property located in Portugal, whether an individual or a corporate entity, resident or non-resident, the taxable basis of income derived from property will be determined according to Portuguese domestic tax law.

Similarly, with respect to transaction taxes, Property Transfer Tax (IMT), Stamp Duty and VAT rules may apply on any property transaction in Portugal.

Corporate tax

Resident companies

Under Portuguese tax law, companies that have their head office or place of effective management in Portugal qualify as Portuguese residents for tax purposes, and are therefore subject to Portuguese CIT on their worldwide income.

The taxable income of Portuguese resident companies is subject to a main CIT rate of 21%, plus a local surtax (*derrama municipal*) which is levied by several municipalities in Portugal, of up to 1.5% of taxable profit, not considering any tax losses carry forward.

State surtax (*derrama estadual*) also accrues as follows: (i) 3% for taxable profit between €1.5m and €7.5m; (ii) 5% for taxable profit above €7.5m and up to €35m; and (ii) 9% for taxable profit above €35m.

The basis of the taxable income is the gross income realised on the property, less allocable expenses and depreciation. Allocable expenses include repair, maintenance, renovation and similar costs, and interest expenses on loans taken out to finance the respective acquisition. Tax depreciation charges are allowed.

Capital gains or capital losses realised on the sale of property are treated as part of the company's taxable income for CIT purposes. Capital gain or capital loss realised corresponds to the difference between the sales price, net of inherent charges, and acquisition cost, (net of tax impairment losses and accumulated tax depreciation charges) updated by an official monetary correction index (for real estate held over two years).

Please note that when the sales price of the property is lower than its Tax Registration Value (TRV), the seller must either: (i) adjust the annual CIT return for the amount corresponding to the positive difference between the TRV and the amount stipulated in the sales agreement; or (ii) prove to the Portuguese Tax Administration that the price of the transaction was effectively lower than the TRV of the building.

A reinvestment relief mechanism is not available in case of investment property.

The accounting rules applicable to statutory accounts (SNC) are in line with the International Financial Reporting Standards. According to the SNC, property classified as investment property it may be valued according to the following criteria:

- cost model; or
- fair value model.

The main features of the **cost model** for tax purposes are:

This holds true unless the Portuguese Tax Administration, upon a request submitted to the Ministry of Finance within 30 days upon the transfer of the shares, authorise otherwise.

Non-resident companies

Under Portuguese corporate tax law, distinction has to be made between non-residents with a PE, and non-residents without a PE located in Portugal.

PEs of non-resident entities are subject to similar CIT rules to those applicable to Portuguese resident entities. Hence, the basis for the taxable income of entities investing in Portuguese property is the gross income, including capital gains realised on the property, minus allocable expenses and depreciation (if applicable).

For non-residents without a PE in Portugal, income derived from property located herein will be subject to CIT as follows:

- Rents received will be subject to a provisional 25% withholding tax (WHT), where the entity paying the income is required to have accounts and bookkeeping. The tax withheld corresponds to an advanced payment on account of the final tax due, with a final rate of 25% applicable. Tax refunds for the difference are allowed. Where the rents received are paid by entities not required to have accounts and bookkeeping, no provisional WHT is levied.

- Capital gains realised on the disposal of property will be subject to a 25% CIT rate.

- When owned by an entity resident for tax purposes in a tax haven, according to a list published by the Government (tax haven entity), unused property or property not allocated to an economic activity is always deemed to be let and, consequently, generating rental income. For tax purposes, the deemed annual gross rental income is one-fifteenth of the TRV. This rule is not applicable where the tax haven entity is able to demonstrate that the property is not used by an entity domiciled in Portugal and is indeed vacant.

Personal income tax

Resident individuals

Individuals resident in Portugal are liable for personal income tax on their income arising worldwide.

In general terms, a person is deemed to be tax resident in Portugal if one of the following conditions is met:

- More than 183 days are spent in Portugal in any 12-month period starting or ending in the fiscal year concerned; or

- Having spent less than 183 days in Portugal, a person maintains a residence suggesting being a habitual residence in Portugal in the above 12-month period.

Depending on the circumstances, the splitting of the tax year may be applicable, ie, a taxpayer can be considered as tax resident only during a part of the year.

An individual that transfers its tax residency to a country or jurisdiction listed as a tax haven is also deemed to be tax-resident in Portugal in the year of the transfer and in the following four years, unless the individual is able to prove that there are good

reasons for that transfer, such as the carrying out of a temporary activity for a Portuguese company.

The general principle is that resident individuals investing in property located in Portugal are subject to personal income tax on the income allocated to the property. Nevertheless, a distinction has to be made between individuals carrying out a business undertaking, and individuals owning properties outside the scope of a business undertaking.

In the former case, the taxable income is determined under the rules applicable to Portuguese resident companies (see section '*Direct investments in Portuguese property*' – '*Corporate tax*'). Tax losses arising from the business undertaking can be carried forward to offset profits arising from the same business undertaking within the subsequent five years.

Taxable income is subject to progressive tax rates, which vary between 14.5 % and 48%, depending on the respective tax bracket. In addition, an additional solidarity rate of 2.5% on the taxable income between €80,000 and €250,000 and of 5% on taxable income exceeding €250,000 may be due.

In the case of individuals obtaining income from property located in Portugal, which does not qualify as profits of a business undertaking, these are subject to personal income tax as follows.

The concept of property rent is defined by the tax law in very broad terms and includes, among other items, fees for services provided in relation to leased property, lease of equipment, fixtures and fittings installed in the leased property, etc.

Tax may be withheld, on the rent, depending on the tax status of the entity paying it. While rents paid by companies, entrepreneurs or independent professionals required to have accounts are subject to a 25% provisional WHT, no provisional WHT applies in the case of rents paid by non-professional individuals.

Net rental income is subject to taxation at the rate of 28%. Or if the individual opts to add such rental income to its remaining income, they will be subject to progressive tax rates.

Capital gains realised on the disposal of property is equal to the difference between sales price and acquisition cost. Duly documented improvement expenses, incurred in the previous twelve years, plus costs inherent to the disposal are added to the acquisition cost. In order to exclude purely nominal or inflationary gains, the acquisition cost is multiplied by the official monetary devaluation index. The capital gains obtained are subject to tax in 50%.

Capital gains and capital losses should be included in the annual income tax return, and they are subject to progressive tax rates, which vary between 14.5% and 48%, depending on the respective tax bracket. In addition, an additional solidarity rate of 2.5% on the taxable income between €80,000 and €250,000 and of 5% on taxable income exceeding €250,000 may be due.

Non-resident individuals

Non-resident individuals are subject to personal income tax on the capital gains arising from the sale of property located in Portugal, at the autonomous rate of 28%.

Net rental income for non-resident individuals is subject to an autonomous rate of 28%.

Residents from another country of the European Union (EU) or of the European Economic Area (EEA) may opt to have their capital gains or rental income taxed at the same rates as Portuguese residents, ie, between 14.5% and 48%, depending on the respective tax bracket (for residents in the EEA, the country in question must have a tax information exchange in place with Portugal). In addition, an additional solidarity rate of 2.5% on the taxable income between €80,000 and €250,000 and of 5% on taxable income exceeding €250,000 may be due. However, to calculate the applicable tax rate, the individual's worldwide income is taken into account, as for Portuguese resident individuals.

Double tax treaties concluded by Portugal grant Portugal the right to tax income derived from property located in Portugal.

Property taxes

Property transfer tax (Imposto Municipal sobre as Transmissões Onerosas de Imóveis, or IMT)

IMT is levied on the transfer of ownership of property located in Portugal. The IMT rates vary according to the type of use of the real estate: (i) 6%, in case of residential real estate above €550,836; (ii) 6.5%, in case of other urban real estate such as retail, offices or land for construction; and (iii) 5%, in case of rural land.

In relation to the acquisition of residential property, the 6% rate may be reduced if the purchase price does not exceed a certain amount, which is updated every year. Full exemption is also available for lower amounts (in 2018 less than €92,407).

When the acquirer is an entity domiciled in a tax haven jurisdiction (not an individual), IMT is levied at a rate of 10%.

IMT is applied to the higher of the purchase price or the official TRV, appraised under the annual local property tax (IMI) rules. This tax is borne by the acquirer, whether resident or non-resident in Portugal.

For IMT purposes, we list below several actions that are deemed transfers of property:

- Promissory sale or exchange of property agreements in which the economic ownership transfer of the properties occurs.
- Letting of property for more than 30 years.
- Direct acquisition of at least 75% of the share capital of private limited liability companies, general partnerships, or limited partnerships that own property, located in Portugal. This rule is also applicable to direct acquisition of at least 75% of the units of close ended real estate investment funds.
- Irrevocable powers of attorney related to property acquisitions or share capital of limited liability companies in the conditions stated above.
- Transfer of contractual position foreseen in promissory sale agreement.

Several exemptions from this tax are available, in particular, for the following situations:

- Operations qualifying as company restructuring or cooperation projects, which are:
  - mergers;
  - split-ups or spin-offs through transfer to a newly established company of all the assets of other companies, which are allocated to a technically independent business, provided that the transferor ceases to engage in the corresponding activity, upon previous request and approval;
  - the acquisition by an existing company, under certain conditions, of all the assets of other companies, which are allocated to a technically independent business, provided that the transferors cease to engage in the corresponding activity.
- The acquisition of property bound for resale by real estate trading companies (resale of properties) may also benefit from IMT exemption. The acquirer needs to demonstrate to the tax administration that is acquiring the property for resale and is acting in its normal course of business. Further, for this purpose, the same property has to be sold within three years, and the new purchaser may not acquire it for resale again.

Stamp duty

As a general rule, stamp duty is levied on the transfer of property ownership at 0.8%. The taxable basis is the purchase price, or the TRV appraised under IMI rules, if higher.

However, if the transfer of property is subject to VAT (by means of waiving the VAT exemption), it is not subject to stamp duty.

Annual local property tax (Imposto Municipal sobre Imóveis, or IMI)

IMI is the municipal tax levied on the ownership of property. The tax is due by the owner of the property on 31 December of each year.

According to the IMI rules, the TRV of the urban properties is updated on a triennial basis, based on 75% of the official monetary devaluation index.

IMI is levied on the definitive assessed TRV of land and buildings located within each municipality. The corresponding rates are:

- Rural property – 0.8%.
- Urban property– 0.3% to 0.45%.
- Tax resident in a tax haven owning urban property in Portugal, except for individuals – 7.5%

The applicable rates for urban property held by either Portuguese residents or non–residents (but not residents in a tax haven), can be tripled annually in the event that the building is unoccupied for over one year or in ruins.

Several IMI exemptions are available. Among others, we highlight the following:

- Property owned by the State and other State-owned entities.

- Houses or flats considered as permanent places of abode.
- Buildings qualified as historical property.
- Historical stores, recognised by the municipalities as establishments of historical, cultural or social interest and that integrate the national inventory.
- Property acquired by property trading companies under certain conditions.

This tax is allowed as a deduction in the computation of corporate tax, for companies owning and using land or buildings for their business undertaking.

Additional to the IMI (AIMI)

AIMI is due by individuals and corporations, as well as by structures or collective bodies without autonomous legal personality and undivided inheritances, that are owners, usufructuaries or have the surface right of urban properties located in Portugal, intended for residential purposes and land for construction.

The taxable basis corresponds to the sum of the TRV of all the urban properties held by each taxpayer, reported as at 1 January of each year.

Properties that benefited from IMI exemption or were not subject to IMI in the previous year are excluded from the taxable basis.

This tax is allowed as a deduction in the computation of corporate tax, for companies owning and using land or buildings for their business undertaking.

In case of individuals and undivided inheritances, a deduction of € 600,000 to the taxable basis is foreseen. Married or living in non-marital partnership taxpayers, who opt to submit a joint tax return, have the right to deduct €1.2m.

In case of individuals, the following rates apply:

- 0.7% for properties with a taxable basis (after the deduction of the referred deductions) not exceeding € 1m (or € 2m in case of married or living in non-marital partnership taxpayers, who opt to submit a joint tax return for AIMI purposes); and
- 1% for the part of the taxable basis that exceeds €1m.

In case of properties owned by corporations it is applicable a rate of 0.4% on the taxable basis. However, in case of properties intended for the personal use of its shareholders or other members of the management and supervisory bodies of such corporation, the applicable rates is 0.7% for the taxable basis up to €1m and 1% for the part of the taxable basis that exceeds such amount.

Properties owned by entities domiciled in a tax haven, the Additional to the IMI is levied at a rate of 7.5%.

AIMI can be used as a tax credit up to the fraction of the personal income tax due on the rental income, whether such income is taxed as rental income or is added to the remaining income and liable to progressive tax rates.

The personal income tax credit is also applicable to the taxpayers that obtain business and professional income related to accommodation or business activities.

AIMI can be used as a tax credit up to the fraction of the CIT related to income obtained from lease and lodging activities. In this case, the AIMI expense will not be considered for the determination of the taxable income.

Urban rehabilitation

Legal aspects

In Portugal there are two types of construction contracts: (i) if the construction owner is a public entity, the contract is regulated by the Portuguese Law of Public Contracts; or (ii) if the construction owner is not a public entity, the construction contract regulated by the Portuguese Civil Code.

In Portugal, pursuant to article 89 of the Decree Law 555/99, of 16 December ("*Regime Jurídico da Urbanização e Edificação*") there is a duty of conservation imposed on building owners. Law imposes an obligation of performing conservation works at least, every eight years. If a building is in danger of collapsing, the municipality may order its demolition.

Also, according to Decree Law, 307/2009 of 23 October, there are some situations where urban rehabilitation may be performed under this specific framework, namely when it comes to buildings with a certain historic/cultural value.

Tax aspects

The Portuguese Urban Rehabilitation Regime provides tax incentives for the rehabilitation of properties that started on or after 1 January 2008 and are concluded by 31 December 2020.

The property subject to rehabilitation must fulfil certain requirements related to its lease status or its physical location.

In broad terms, this regime includes several tax incentives. Among others, we highlight:

- Possible IMI exemption for urban property subject to rehabilitation, applicable for a period of five years, which may be renewed for a subsequent period of five years.

- Possible IMT exemption for the acquisition of urban property considered a permanent place of residence destined for urban rehabilitation. It must be the first transaction of the building after the rehabilitation and the building must be located in an urban rehabilitation area.

- Income obtained by both individuals and corporate investors and derived from the units held in the referred funds is subject to a WHT rate of 10% for income tax purposes.

Several particularities apply in the case of tax-exempt entities and non-residents.

Value-added tax (VAT)

General

The current standard VAT rates are: (i) 23% (on the mainland); (ii) 22% (on the island of Madeira) and; (ii) 18% (on the islands of the Azores).

In accordance with the Portuguese VAT code, operations subject to IMT are VAT-exempt. As a result, the transfer of property subject to IMT is, as a general rule, exempt from VAT. Although there are some exceptions, the leasing of property is also a VAT-exempt operation under the Portuguese VAT code.

As a general rule, services rendered connected to a property located in Portugal are subject to VAT herein.

Transfer of property/leasing (exemption waiver)

The general rule in Portugal is that the sale/leasing of property is VAT-exempt.

Nevertheless, in order to minimise the effects arising from this exemption, it is possible to waive the VAT exemption upon the fulfilment of several strict conditions.

In order to qualify for the exemption waiver, several strict conditions need to be met. According to the VAT-exemption waiver regime on real estate transactions, there are three main types of conditions that need to be met:

1. Conditions regarding the property & leasing agreement:

- The property (land for construction, building, or autonomous unit of a building) is registered for tax purposes.

- The property is registered in the name of the owner or landlord, and it cannot be residential property.

- The sale or the lease agreement needs to cover the totally of the property unit.

- The property unit is allocated to the undertaking of VAT-able transactions, ie, those that give a right to deduct input VAT.

- In the specific case of lease agreements, the annual rent should amount to at least one-twenty-fifth (1/25) of the acquisition cost or construction cost of the property.

2. VAT status of the property

Once all conditions above are met, it is only possible to apply for the VAT-exemption waiver (charging VAT on the sale or lease agreement), if one of the following situations arises:

- In the first sale or letting following the construction of the property where it is possible to recover the total amount (or part) of the input VAT arising from the construction. In the first sale or letting upon major improvement works that increase the TRV of the property by more than 30%, when input VAT can still be recovered.

- In every subsequent sale or letting followed by a previous VAT transaction, when the property is still within the claw back period (in certain cases, VAT recovered may need to be paid back to the Government Revenue department, currently 20 years).

It is not possible to waive the VAT exemption in the case of subletting, except when the building is used for industrial purposes.

3. Status of the parties

Regarding seller/landlord and the acquirer/tenant, respectively, being VAT taxpayers, both parties need to:

- Have VAT-able revenue exceeding 80% of total turnover. This rule may exclude the possibility of a waiver in the case of insurance companies, banks and financial institutions, the State and municipalities in general, when using the property or letting of property.

- Having accounts prepared under local adopted accounting principles, as required by both personal and corporate income tax codes.

This means that entities that own property in Portugal which are considered non-resident without a PE in Portugal, are not able to apply for the VAT exemption waiver, and are therefore not able to recover any input VAT.

The VAT exemption waiver is requested on a transaction basis, in respect of each building/land sold or leased, through a request made by the seller/landlord to the Portuguese VAT administration on its internet website; and it has to be obtained prior to the signing of the sale or lease agreement.

Input VAT incurred with each operation or project, and with construction works, is deductible, from the moment the property is allocated to VAT-able operations, for a period of four years back from the date of each invoice issuance.

In the event of an acquisition of property, VAT will be self-assessed by the acquirer, meaning that VAT will be charged and deducted, if and when possible by the acquirer of the property.

Right to deduct input VAT

The VAT deduction regime in case of property activities is the allocation method, ie, deduction per distinct activity, which allows the deduction of VAT on a separate basis for each taxable and exempt activity which requires separate accounts per activity.

Regarding expenses that it is not possible to allocate to a specific activity, entities are entitled to deduct VAT on the proportion of the taxable operations carried out, based on a specific method of calculation (pro rata method).

Taxable persons are allowed to combine both VAT deduction regimes.

In the case of VAT exemption waiver, deduction of total input VAT can only be claimed after the acquisition agreement or the definitive leasing contract is signed (in both cases prior VAT exemption waiver certificates must be obtained).

VAT returns should be filed on a monthly or quarterly basis, depending on whether the annual turnover equals or exceeds €650,000, being delivered to the VAT administration by the tenth day of the second subsequent month after the month when the chargeable events occurred. Quarterly returns have to be filed with the Portuguese Tax Administration by the fifteenth day of the second month after the respective quarter calendar ends.

VAT recovery on property is subject to a VAT claw back during a period of 20 years (10 years for properties acquired before 13 February 2001), during which certain

occurrences may require VAT adjustments. The right to VAT deduction is attributed, provided the property is allocated to a VAT-able activity. Any modifications to this situation in the course of the 20 (10)-year period since the occupation of the property require adjustments of VAT on behalf of the revenue.

Acquisition of a Portuguese property company

General

Companies or individuals wishing to invest in Portuguese property may acquire the shares in a company owning property, rather than make a direct purchase of the property.

Given the fact that the company may have a tax history and contingent liabilities, it is generally advisable to conduct a tax due diligence review of the target company. In such a due diligence, corporate tax, VAT and the transfer tax position of the company should be checked. If necessary, the seller of the company should be asked for certain guarantees on the tax position of the company.

Legal Aspects

Corporations in Portugal

The most common vehicles for investment are the private limited liability company, (*Sociedade por Quotas*, or SQ), and joint-stock company (*Sociedade Anónima*, or S.A.).

Joint-stock company (*Sociedade Anónima*)

Shares may be registered in books (book entries) or represented by share certificates (also called certificated securities) depending on whether they are represented by registrations in an account or by paper documents.

Procedures for transfer of shares consist of a written declaration of the holder and a registry entry in the company's share registration book.

The articles of association may not exclude or limit the transferability of shares otherwise than as permitted by law.

Private limited liability company

The transfer of quotas has to be executed by a written document and registered with the commercial registry office. Consent from the company is required, save for transfers to other shareholders or family (spouse, ascendants, descendants) and unless the consent requirement is waived by the by-laws of the company or by means of a quotaholder's agreement.

Tax aspects

Corporate tax

Resident companies

If shares in the capital of a company owning property are acquired by another company, the latter company must value the shares in the acquired company at the acquisition cost.

Contrary to a direct purchase of property, the purchaser of the shares in a property company does not benefit from any step-up in the fiscal value of the property, since for corporate tax purposes, the company owning the property must continue to value the property at its original acquisition cost, even if booked at fair value. Hence, the fiscal value of the underlying property will remain the same, and the annual tax depreciation will be lower, compared to a direct purchase of property.

Dividends may be exempt from corporate income tax. Besides the subsidiary being subject to corporate tax, the following conditions (among others) should also be met:

- Holding level: the parent company must have a shareholding of at least 10%.
- Holding period: the respective shareholding must be held for one consecutive year before being entitled to the exemption, or, since the incorporation date of the subsidiary, if this period is shorter, providing the same one-year holding period is observed.

If the conditions above are not met, taxation will arise and WHT will apply. The corporate income tax withheld constitutes an advanced payment on account of the final tax due by the company receiving the dividend.

Capital gains (and capital losses) realised on the sale of shares are the difference between sales price and acquisition cost of the shares (updated by the official monetary devaluation index, applicable upon a minimum holding period of two years). Capital gains are exempt from CIT, as long as, among other conditions:

- The parent company must have a shareholding of at least 10%;
- The participation is held for at least one year;
- The subsidiary does not have more than 50% of its total assets in the form of real estate located in Portugal. In this case, for the computation of the percentage level it does not include real estate that is used as commercial activity, except for in case of buying and selling real estate activity.

In case the above mentioned conditions are not met, capital gains (and capital losses) realised on the sale of shares are part of the company's taxable income.

Non-resident companies

Dividends distributed by a resident-affiliated company to a non-resident parent company are subject to a 25% WHT (or 35% if distributed to a resident in a country, territory or region subject to a clearly more favourable tax regime, ie, a tax haven entity).

Under the application of the domestic participation exemption regime (that is applicable to both EU and non-EU residents and fully in line with the EU Parent-Subsidiary Directive), this 25% WHT rate can be eliminated where non-resident parent company, among other conditions, holds at least 10% of the share capital of the affiliated company resident in Portugal for at least one consecutive year, or, since the incorporation date of the subsidiary, if this period is shorter, providing the same one-year holding period is observed.

Where the minimum holding period of one consecutive year is not observed, provisional WHT under domestic law is levied. Such provisional WHT may be refundable when the minimum holding period of one year is achieved.

The WHT rate may also be reduced, usually to 15% or 10%, under the double tax treaties concluded by Portugal.

Capital gains arising from the sale of shares acquired before 1 January 2001 held in Portuguese resident property companies by non-resident companies are exempt in Portugal.

Capital gains arising from the sale of shares acquired on and after 1 January 2001 held in Portuguese resident companies, whose assets are comprised in more than 50% by property located in Portugal, by non-resident entities are subject to 25% CIT in Portugal. This tax may be avoided, depending on whether the non-resident entity is entitled to the protection of a double tax treaty that does not give the right to Portugal to tax such capital gains.

Capital gains shall be liable to taxation in Portugal, whenever they result from the transfer of share capital or similar rights in any entity (non-resident in Portuguese territory), when, in any given time in the past 365 days, the value of those shares or rights result, directly or indirectly, in more than 50% of immovable property or rights in rem over immovable properties located in the Portuguese territory (except if related to agricultural, industrial and commercial activity and not the sale and purchase of immovable property).

Personal income tax

Resident individuals

Dividends are subject to a 28% WHT. It corresponds to the final taxation of such income, unless the individual opts to include the respective amount within their overall income, in which case the tax withheld corresponds to an advance payment of the final tax due under the marginal rates applicable to the total income, which vary between 14.5% and 48%, depending on the respective tax bracket. In addition, an additional solidarity rate of 2.5% on the taxable income between €80,000 and €250,000 and of 5% on taxable income exceeding €250,000 may be due. In this case tax refunds are allowed.

Capital gains arising from the sale of shares, including the ones held in the share capital of property companies, are subject to taxation at the rate of 28%. Or, if the individual opts to add such capital gains to the remaining income, they will be subject to progressive tax rates. In this case, tax refunds are allowed.

The taxable gain is equal to the difference between the sales price and acquisition cost of the shares, (updated by the official monetary devaluation index, applicable upon a minimum holding period of two years). Expenses related with the purchase and sale can be deducted to the acquisition cost and to the sales price respectively.

Non-resident individuals

Dividends paid to non-resident individuals are subject to WHT at a standard rate of 28% (or 35%, if distributed to a resident in a country, territory or region subject to a clearly more favourable tax regime). The WHT rate may be reduced, usually to 15% or 10%, under the double tax treaties concluded by Portugal.

Capital gains arising from the sale of shares held by non-resident individuals in property companies resident in Portugal are taxed at a 28% flat rate. This taxation may be avoided, depending on whether the non-resident entity is entitled to the protection of a double tax treaty that does not give the right to Portugal to tax such capital gains.

Property transfer tax (IMT)

In principle, the acquisition of shares in a company owning Portuguese property does not qualify as an acquisition of property itself; it remains, therefore, outside of the scope of this tax.

However, an exception to this principle applies in cases where shares representing 75% or more of total share capital of an Lda company, of a general partnership, or of a simple limited partnership, owning property are acquired (see section '*Investing in Portuguese property through a partnership*').

Value-added tax (VAT)

The acquisition of the shares in a company owning Portuguese property is not subject to VAT.

Investing in Portuguese property through a partnership

The term 'partnership' may be misleading for investors from most countries, whose legal systems include similar types of business organisation, but according to which they are non-incorporated entities, ie, are not considered as legal entities separate from their partners.

In fact, under Portuguese company law, partnerships are incorporated, meaning they have a legal existence separate from the partners, with several consequences at different levels, eg, in the field of taxation, where the tax transparency regime is not automatically applicable on the grounds of the legal form adopted.

Investing in Portugal through a real estate investment fund

Under the Portuguese Collective Investment Vehicles regime, it is possible to incorporate an investment vehicle either under contractual form (Real Estate Investment Fund, or REIF) or corporate form (*Sociedade de Investimento Imobiliário*, or SIIMO).

General

Real estate investment funds and the management company

The sole purpose of real estate investment funds established under Portuguese law is to invest, according to a shared risk principle, funds obtained from investors. Assets are separate and autonomous from the unit holders, but are jointly owned by them. The fund is not a legal entity and it is ruled in the fund by laws.

It is mandatory that they are managed by management companies, which must be incorporated as joint-stock companies (*Sociedades Anónimas*, or SA), with an effective head office in Portugal. Its statutory objective should mainly be to manage one or more funds for the account of the respective unit holders.

Types of real estate investment funds

These funds are divided into investment units and can either be: (i) opened-ended, in which case the units are issued in a variable number and (ii) closed-ended, where the units are issued in a fixed number.

Regulatory aspects to be considered

The setting up of a real estate investment fund is subject to prior authorisation from the Portuguese securities market commission (CMVM) upon request of the management company. CMVM is responsible for the supervision of the fund.

Qualifying assets

The qualifying assets to these funds are: (i) urban properties or buildings divided into horizontal property regime (condominium regime) and rural/farm land; (ii) investment units in funds; (iii) cash instruments, such as bank deposits, certificates of deposits; (iv) shareholdings in property companies under certain circumstances.

Taxation regime of real estate investment funds

Taxation at the real estate investment fund level

For CIT purposes, the taxable profit of real estate investment fund incorporated under Portuguese law corresponds to the net income of the period, computed in accordance with the applicable accounting standards. However, the following income/expenses, among others, are disregarded:

- Investment income, rental income and capital gains (unless if derived from tax heaven entities);
- Expenses related to the income referred above;
- Income and expenses related to management fees and other commissions reverting to the fund.

The computed taxable income is subject to the main CIT rate (currently of 21%). The real estate investment fund is exempt from local and state surtaxes, being however subject to autonomous taxation foreseen in the CIT code for certain expenses.

Tax losses generated by the fund can be carried forward to offset taxable profits arising in the following five years. No carry back is allowed.

Deduction of tax losses' brought forward is limited to 70% of the taxable profit of the year, with the possibility of carrying forward the remaining 30% within the carry forward period.

The real estate investment fund is also subject to stamp duty levied on its net asset value at a rate of 0.0125%. The stamp duty is assessed quarterly, in March, June, September and December of each year and should be paid before the 20th day of the month following the end of the quarter.

Property acquired/owned by the real estate investment funds that are set up and operate in accordance with the Portuguese law is fully subject to IMT, annual IMI, and stamp duty. Stamp duty is not levied when VAT is charged on the transaction.

Taxation at the unit holder level

The income obtained by resident investors or PEs in Portugal of non-resident investors is subject to taxation at personal income tax level (generally, at the rate of 28%) or at CIT level (being considered in the taxable profit of the investors, taxed at the CIT rate of 21%, plus municipal and state surtaxes, if applicable).

The income obtained by non-resident investors without PE is taxed at a 10% rate, including redemption and capital gains.

Different rules apply if the investor, among others, (i) is domiciled in a tax haven; or (ii) as a general rule, is directly or indirectly held in more than 25% by tax residents in Portugal.

For double tax treaty purposes, distribution income and gains derived from the redemption and sale of units qualify as income from immovable real estate.

Property transfer tax (IMT)

As a general rule, the acquisition of units in a real estate investment fund is not subject to IMT. However, an exception to this rule applies to the acquisition of units of privately placed close ended real estate investment funds, as well as redemptions, capital increase and decrease operations, among others, when one of the unit holders, or two unit holders that are married or unmarried but sharing the same tax address, become the owners of at least 75% of the units of the fund.

Other real estate investment funds

Real estate urban rehabilitation investment funds

Real estate investment funds that:

- set up and operate in accordance with the Portuguese law between 1 January 2008 and 31 December 2013;
- whose assets are comprised of at least 75% by properties subject to urban rehabilitation; and
- such properties are located in certain specific areas

are fully exempt from corporate income tax on all types of income (including rental income and capital gains). These may also benefit from IMT and IMI exemption.

Real estate investment funds for residential letting

This type of real estate fund (*Fundos de Investimento Imobiliário para Arrendamento Habitacional*, or FIIAH) set out according to the Portuguese legislation, between 1 January 2009 and 31 December of 2013, may benefit from several tax benefits until 2020. Some of these benefits are:

- Corporate income tax exemption on all types of income.
- IMI exemption for properties that are part of the portfolio of the FIIAH.

- Property transfer tax exemption for acquisitions made under this regime by the FIIAH.

At unit holder level:

- Personal and corporate income tax exemption on income distributed by the fund. This exemption does not apply to capital gains arising from the sale of such participation units.

Some tax benefits may also be applicable to individuals that sell their residential properties and subsequently sign a lease agreement for such property. Several conditions need to be met.

The above-referred tax regime and respective exemptions are not applicable to entities resident in a country or jurisdiction with a more favourable tax regime (listed tax havens).

Investing in Portugal through *Sociedades de Investimento Imobiliário* (SIIMO)

General

The *Sociedades de Investimento Imobiliário* (SIIMO) were introduced in June 2010. They are regulated investment vehicles for investing in real estate.

The SIIMO are collective investment schemes adopting the legal form of a joint stock company (*Sociedade Anónima*), which can either be a fixed capital company (SICAFI) or a variable capital company (SICAVI), whose assets are managed, on a fiduciary basis, on the sole interest of their shareholders. SIIMO can be internally managed, or managed by an independent management company. Assets are entrusted to a depositary bank.

Regulatory aspects

There is regulatory supervision of the SIIMO, being the regulatory authority the CMVM. The management company, if any, is governed by the banking law, is supervised by the Bank of Portugal and is only allowed to manage regulated SIIMO.

Periodical financial reports are sent by the management company to the CMVM.

Taxation of SIIMO

As a general rule, SIIMOs are taxed under the same rules as apply for real estate investment funds for both income and property taxes.

Financing the acquisition of Portuguese property

Legal aspects

Minimum share capital

One of the main differences between a private limited liability company (*Sociedade por quotas*) and a joint-stock company (*Sociedade Anónima*) is the minimum share capital required for their incorporation.

For a *Sociedade Anónima* the requirement is €50,000 and the payment of 70% of the contributions to be made in cash may be deferred. For a *Sociedade por Quotas* the requirement is €1 per each quota and a minimum of 2 quotas.

Minimum debt/equity ratio

Pursuant to article 35 of the Companies Code, when it results from the company's accounting that half of the share capital has been lost, the directors must immediately convene a general a General Assembly to inform the remaining shareholders of this situation.

The agenda for the General Assembly must contain three specific topics: (i) dissolution of the company; (ii) share capital reduction to an amount no lower than the company's equity; and (iii) equity increase made by the shareholders.

Mortgage and other guarantees

Mortgages are the most common type of collateral, which guarantees the payment of a specific credit. It can be voluntary or legal, depending on the reason for its creation. For example, bank mortgages for the purpose of granting loans are voluntary mortgages and mortgages for the guarantee of a specific debt to a public entity (such as the Social Security or the Tax Authority) are legal mortgages.

It should be stressed out that the registration of mortgages with the relevant Land Registry Office is essential for the validity and enforceability of the guarantee.

Portuguese law contemplates a special procedure for mortgage foreclosure. Preferentially, property will be subject to a sale through electronic auction. If this mean is frustrated, then property will be sold through Sealed bidding procedure and the highest bidder will, generally, become the new owner.

Tax aspects

Equity financing

Under Portuguese tax law, subscription and paying in of statutory share capital at incorporation as well as subsequent increases are not subject to stamp duty.

Registry fees, as well as other related expenses (eg, contractual expenses), are due on this type of operation.

If the contributions of the shareholders are made in kind by means of a transfer of property to the company, property transfer tax, or IMT, will be levied under general rules (see section *'Direct investments in Portuguese property' – 'Property taxes'*).

Debt financing

Deductibility of interest

The general principle regarding the acceptance of costs and expenditures as tax-deductible expense is that these are necessary to assure or obtain income subject to taxation.

To this extent, interest and other financial expenses arising from related parties' transactions are, in principle, tax-deductible, provided they are established at arm's length.

Under the net financial expense's capping rule, their deductibility is limited to up to the higher of: (i) a fixed cap: €1m; or a (ii) variable cap: 30% of the profit obtained before depreciation, net financing expenses and taxes (for simplification purposes also referred to as tax EBITDA).

WHT on interest

Resident entities

Interest received by Portuguese resident companies, arising from loans and paid by an entity taxable in Portugal, are subject to a 25% WHT, which assumes the nature of an advance payment of the final tax due.

No WHT applies, in case of shareholders loans when the shareholder holds at least 10% shareholding for a consecutive year before interest are made available.

Interest received by resident individuals, arising from loans and paid by an entity taxable in Portugal, is subject to 28% WHT and can be regarded as final tax.

Non-resident entities

Interest received by non-resident companies, arising from loans and paid by an entity taxable in Portugal, are taxed at a 25% (or 35% if due to a resident in a country, territory or region subject to a clearly more favourable tax regime) flat withholding rate, in cases where the entity receiving the interest is resident in a country that has not signed a double tax treaty with Portugal.

Under the Interest-Royalty Directive, no WHT may be levied. The minimum shareholding level and holding period required are 25% and two years respectively. The definition of associated company is in line with the one set out in the Directive.

In case of non-resident individuals, interest arising from loans and paid by an entity taxable in Portugal, are taxed at a 28%.

Interest paid or made available to accounts opened in the name of one or more holders acting on behalf of one or more unidentified third parties is subject to a final withholding tax rate of 35%, unless the beneficial owner of the income is identified.

Where the beneficiary is resident in a country that has concluded a double tax treaty with Portugal, the withholding rate may be reduced, in most cases to 10% and 15%.

Indirect taxes (stamp duty)

Stamp duty is levied at different rates on different aspects/components of financing operations. In this respect, it is important to distinguish between those concluded with

banks or other credit institutions, and those established with the company's shareholders.

In the former case, stamp duty applies as follows:

- Principal lent or capital guaranteed, depending on the maturity, at 0.04% per month for funding up to one year, at 0.5% for funding with maturity varying from one year to less than five years, and 0.6% for five or more years.
- Commissions on guarantees, at 3%.
- Interest, commissions and other fees charged by banks or financial institutions, at 4%.

Shareholders' loans may also be subject to stamp duty, although several exemptions are available, depending on the specific terms and conditions of the transaction.

Real estate financial lease

The financial lease contract (*Contrato de Locação Financeira)* is regulated in Decree-Law No. 149/95 of 24 June, and is defined as the contract where one party (finance lessor) grants a finance loan and also, upon monthly instalments, a temporary use of property, under an agreed term. The other party (finance lessee) undertakes to pay the monthly instalments and to render the property by the end of the agreed period, unless it opts to buy the property.

A financial lease agreement can be performed in a private document, but signatures must be certified. Also, the construction/use permit must be certified alongside with the signatures.

Once the financial lease agreement term elapses, the lessee has three options: (i) exercise the purchase option for a certain amount; (ii) return the property to the leaser; and (iii) renew the contract for another period of time.

Transferring real estate

According to the Land Registry Code, every act which modifies the ownership of a certain real estate property must be registered before the Land Registry Office. Also, every transfer of property must meet all requirements established in the Portuguese Civil Code.

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