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Portugal

Introduction

Although the arm's-length principle has been included in Portuguese tax law for many years, it generally was not enforced, due to a lack of clarity and supporting regulations. However, this changed in December 2000, when new Portuguese transfer pricing legislation was enacted.

Statutory rules

Law number 30-G/2000 of 29 December 2000, which entered into force on 1 January 2001, by amending Article 57 of the Portuguese Corporate Income Tax (CIT) code, introduced detailed transfer pricing rules. This article was subsequently changed into Article 58 by decree-law number 198/2001, dated 3 July 2001 (decree-law 198/2001) and changed again into Article 63 by decree-law number 159/2009, dated 13 July 2009 (decree-law 159/2009). The new transfer pricing documentation rules are applicable to tax years starting on or after 1 January 2002.

Article 63, number 13 of the CIT code states that a Ministerial Order from the Minister of Finance will regulate, amongst others, the application of the transfer pricing methods, the type, nature and contents of the documentation and the procedures applicable to (corresponding) adjustments. This Ministerial Order, number 1446-C/2001, dated 21 December 2001 (Ministerial Order1446/C-2001), was published in the *'Diário da República'* on 14 January 2002.

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Article 63 CIT Code

The key elements of the transfer pricing rules are as follows:

- The concept of 'special relations' between entities is broadly defined, including situations ranging from statutory to economic dependency, and also certain family relations.
- A set of defined methodologies for evaluating transfer prices and the comparability factors that should be taken into account when assessing their arm's-length nature.
- The 'best method' or 'most appropriate method' for every transaction or series of transactions should be considered.
- Extensive requirements regarding how taxpayers justify and document their transfer pricing arrangements.
- A shift in the burden of proof from the tax authorities to the taxpayer (self-assessment procedure) in the case of controlled transactions with non-resident associated enterprises.

Arm's-length principle

Any commercial transactions, including transactions or a series of transactions related to goods, rights, services or financial arrangements between a taxpayer and another entity with which it has special relations must be conducted as if they were independent entities carrying out comparable transactions.

The transfer pricing methodology adopted must ensure the best level of comparability between the tested transactions and the comparable data used to provide the benchmark. Factors affecting comparability include characteristics of the goods, rights or services, economic and financial environment, activities and functions performed, assets employed and risks borne.

The transfer pricing regulations also apply in cases of transactions between a non-resident entity and a permanent establishment (PE) in Portugal or between a PE of a non-resident entity with other PEs outside the Portuguese territory. The rules also apply to entities that are simultaneously exercising activities that are subject to CIT and activities that are exempt from CIT, such as entities based in the Madeira International Business Centre (MIBC).

Associated enterprises

Special relations between two entities exist in case one entity has or may have, directly or indirectly, a significant influence in the management of the other entity. The law stipulates that a special relationship exists in the case of:

- An entity and its shareholders, or its relatives, that have directly or indirectly a participation greater than or equal to 10% of the capital or the voting rights.
- Entities in which the same shareholders, or its relatives, have, directly or indirectly, an interest greater than or equal to 10% of the capital or the voting rights.
- An entity and the members, and their relatives, of its corporate bodies.
- Entities in which the majority of the members of its corporate bodies, or of any other administrative body, board of directors or supervision or control, are the same persons or being different persons are connected with each other by marriage, other (legal) forms of joint households or by direct parental relation.
- Entities connected by a contract of subordination or other with equivalent effect.
- Entities that are required to prepare consolidated financial statements.
- Entities where one of the following relationships exist:
    - The activities of one entity substantially depend on industrial or intellectual property rights or know-how owned and granted by the other entity.
    - The sourcing of raw materials or the access to sales channels of products, merchandise or services for one entity substantially depends on the other entity.
    - A substantial part of the activity of one entity can be performed only with the other or depends on decisions taken by the other entity.
    - The prices for goods or services rendered or acquired by one entity is, by provision set in juridical act, determined by the other entity.
    - Terms and conditions of commercial or juridical relations between the parties have the effect that one entity can influence the management decisions of the other entity in a way other than between two commercial parties acting at arm's length.
- An entity resident in Portugal or a non-resident with a PE in Portugal and an entity resident in a territory considered by Portuguese law as a territory with a clearly more favourable tax regime.

These territories are listed in the Ministerial Order 150/2004, dated 13 February 2004, which has been altered by Ministerial Order 292/2011, dated 8 November 2011.

Transfer pricing methods
The methods to be used are:

- The comparable uncontrolled price method.
- The resale price method.
- The cost plus method.
- The profit split method.
- The transactional net margin method.
- Other methods when the methods mentioned above cannot be applied or if these methods do not give a reliable measure of the terms that independent parties would apply.

Tax information and documentation
Every taxpayer shall indicate, in the annual declaration of accounting and fiscal information (IES/*Declaração Anual*), an integral part of the annual CIT filings, the existence of transactions with associated enterprises.

The requested information includes the associated enterprises, the amount of the controlled transactions with each of the associated enterprises and an indication as to whether supporting documentation for transfer prices was prepared at the time the transactions took place (and is still available).

Taxpayers with turnover of 3 million euros (EUR) or more also should comply with the documentation requirements below.

Corresponding adjustments
Where the transfer pricing provisions apply to controlled transactions between two parties that are both liable to Portuguese CIT, any adjustment to the taxable income of one should be reflected by a corresponding adjustment to the taxable income of the other. If a tax treaty is applicable, then the Portuguese tax authorities may also make corresponding adjustments through the competent authority procedure.

Other regulations
The Ministerial Order 1446-C/2001 deals in more detail with the following issues:

- General rules on the arm's-length principle.
- Scope of application of transfer pricing rules.
- Adjustments to taxable income and corresponding adjustments.
- Transfer pricing methods and the best or most appropriate method.
- Factors determining comparability.
- Cost contribution arrangements and intra-group services.
- Relevant information and supporting documentation.
- Special provisions.

In addition, article 23 of the Portuguese CIT Code considers that costs are deductible only if indispensable for generating profits or gains or for the maintenance of the company's activity. However, the recent Portuguese case law is showing a more business oriented approach of such concept, meaning that it should be sufficient to demonstrate that the costs are related to the company's normal course of activity.

However, non-documented costs or costs not complying with certain formal requirements are not deductible for CIT purposes. Furthermore, such costs are subject to an autonomous tax rate of 50%, even in the case of tax losses.

Legal cases

There have been few court cases on transfer pricing matters. More recent case law shows the importance of a well-prepared factual and functional analysis to support arm's-length dealings with associated enterprises.

Burden of proof

Although under the recent transfer pricing rules, the taxpayer is required to have transfer pricing documentation available demonstrating compliance with the arm's-length principle, according to the *Lei Geral Tributária* (general tax law) the burden of proof lies with the entity that wishes to proof otherwise.

In fact, article 77 of *Lei Geral Tributária* foresees that the proof of incompliance with the arm's-length principle lies with the tax authorities.

In the case of controlled transactions with non-resident associated enterprises, the taxpayer should include any necessary adjustments in its corporate income tax return in order to reflect arm's-length pricing (self-assessment).

Documentation

Tax documentation file

Based on the Ministerial Order 1446-C/2001, taxpayers are required to keep a transfer pricing documentation file, which is expected to include the following information:

- The terms and conditions agreed, accepted and observed in the open market in relation to the controlled transactions.
- The selection and application of the method or methods most appropriate for benchmarking transfer prices through the use of arm's-length comparables.

The transfer pricing documentation file should include the following information and documentation:

- A description of any special relations that exist with any entities with which commercial, financial or other transactions are carried out.
- A record of the corporate relationship by which the special relationship arose, including any documents that demonstrate a subordination or dependency relationship as mentioned above.
- A description of the activities carried out during the controlled transactions, a detailed list of amounts recorded by the taxpayer over the past three years and, where appropriate, the financial statements of the associated enterprises.
- A detailed description of the goods, rights or services involved in controlled transactions and of the terms and conditions agreed if such information is not disclosed in the respective agreements.
- A description of the activities performed, the assets used and the risks assumed, both by the taxpayer and the associated enterprises involved in the controlled transactions.
- Technical studies on essential areas of the business, namely investment, financing, research and development, marketing, restructuring and reorganisation of

activities, as well as forecasts and budgets connected with the global business and business by division or product.
- Guidelines regarding the transfer pricing policy of the company, containing instructions on the methods to be applied, procedures for gathering information (particularly on internal and external comparables), analysis of the comparability of transactions, cost accounting policies and profit margins obtained.
- Contracts and other legal instruments concluded with both associated enterprises and third parties, together with any other document that may govern or explain the terms, conditions and prices under those transactions.
- An explanation of the method or methods applied to determine arm's-length prices for each controlled transaction and the rationale for the selection.
- Information regarding comparable data used (The grounds for selection, research records and sensitivity and statistical analyses should all be documented).
- An overview of business strategies and policies, particularly regarding commercial and operational risks that might have a bearing on the determination of transfer prices or the allocation of profits or losses for the transactions.
- Any other information, data or documents considered relevant for determining an arm's-length price, the comparability of transactions or the adjustments made.

The taxpayer is expected to maintain the documentation for a period of ten years after the filing of the tax return and to deliver the documentation to the tax authorities upon request. The documentation should help to verify the arm's-length nature of the transfer prices without the need for the taxpayer to incur excessive compliance costs.

The tax authorities have four years to raise additional CIT assessments. If tax losses were offset against tax profits within the above-mentioned period, the tax authorities may also audit the accounts of the years in which the tax losses were incurred.

Taxpayers are expected to update the prior-year documentation for transactions where the relevant facts and circumstances have changed to the extent that there is a material impact in the determination of the arm's-length price.

The Ministerial Order 92-A/2011 dated 28 February 2011, revised the set of documentation that needs to be included in the tax file, clarifying that the transfer pricing report is part of the tax file. The precedent legislation, Ministerial Order359/2000 of 20 June 2000, had been in force prior to the introduction of transfer pricing documentation requirements and therefore, did not include any reference to the transfer pricing documentation file.

Cost contribution arrangements (CCAs)

With respect to CCAs, the taxpayer must maintain the following documentation:

- Description of the participants and other associated enterprises involved in the activity covered by the agreement or that are expected to exploit or use the results of that activity.
- The nature and type of activities carried out within the scope of the agreement.
- The method by which each participant's proportionate share in the expected advantages or benefits are determined.
- The accounting procedures and methods applied to allocate costs, including the calculations made to determine each participant's contribution.

- The assumptions that underlie forecasts of expected benefits, frequency of review and forecasts of any adjustments arising from changes in the agreement or in other facts.
- Expected duration of the agreement.
- Anticipated allocation of responsibilities and tasks under the agreement.
- Procedures for a participant entering or withdrawing from the agreement and conditions for the termination of the agreement.
- Penalty clauses.

Intragroup services

Regarding intragroup services agreements, the taxpayer must maintain the following documentation:

- A copy of the agreement.
- A description of the services covered by the agreement.
- A description of the recipient of the services.
- A description of the costs of the services and the criteria applied for their allocation.

Tax audit procedures

The audit procedure can be either internal or external. During an internal audit, the taxpayer is requested to send documentation to the tax authorities for analysis; in an external audit, investigations are carried out at the taxpayer's premises. In the last case, documentation also may be requested from the taxpayer in order to be analysed at the tax authorities' premises.

Furthermore, the audit procedure can be either global or partial. A global tax audit reviews the entire tax status of the taxpayer, while a partial tax audit will focus on only one or more (but not all) of the taxpayer's tax duties. An audit may address more than one taxable period. The tax audit procedure is continual and must be concluded within six months. However, under certain circumstances, this period may be extended.

The audit procedure begins with a notification sent by the tax authorities to the selected taxpayer. This notification sets out the nature and scope of the audit, as well as the rights and obligations of the taxpayer during the audit process.

Audits are completed when the tax auditor considers that all the necessary information has been obtained to draw up a proposed tax audit report. This proposal is sent to the taxpayer, who has the opportunity to oppose, in all or in part, against the conclusions of the proposal. After the objections have been heard, the tax auditor will issue a final audit report, which may give rise to an additional tax assessment.

Revised assessments and the appeals procedure

Following a tax audit, the taxpayer is allowed to challenge an additional tax assessment made by the tax authorities, either by means of an administrative claim submitted to the tax authorities, or via a judicial or arbitration appeal to the tax courts. An appeal against an additional tax assessment does not prevent the collection of additional tax. Therefore, the taxpayer should either pay the tax due or provide a guarantee for its payment.

There are no specific regulations in respect of appeals connected with additional assessments based on the transfer pricing arrangements adopted by the taxpayer.

Additional tax assessment and penalties

In general terms, additional assessments usually carry penalties and fines. The specific penalty in force for not having the transfer pricing documentation file organised ranges from EUR 1,000 to EUR 10,000 (negligence).

In case a taxpayer refuses to deliver the transfer pricing file, after declaring in the Annual Fiscal and Accounting Declaration (IES/*Declaração Anual*) that the transfer pricing file is organised, the applicable penalty that may range from EUR 750 to EUR 150,000.

Penalties for the nonpayment of taxes range between 30% and 100% of the amount of tax due, capped at EUR 45,000, in case of negligence. In case of *dolus*, penalties range between 200% and 400% of the amount of tax due capped at EUR 165,000. The taxpayers may request a reduction of the penalty (under certain circumstances) and may appeal against the penalties imposed by the tax authorities.

Late assessment interest (4% per year) is also charged. Neither penalties nor late assessment interest is deductible for tax purposes. In case of the late payment of an additional assessment made by the tax authorities, interest for late payment will be applied (the interest rate is determined annually, in December, using the monthly average of the *Euribor* at 12 months in the preceding 12 months, adding 5% – regarding 2012 the late assessment payment interest rate is 7.007% per year).

Resources available to the tax authorities

Practice

It is believed that the tax authorities have developed sufficient experience to deal with transfer pricing issues. Various transfer pricing audits have been performed, and recently the tax authorities have started to make transfer pricing adjustments to the taxable profit of taxpayers.

Use and availability of comparable information

Use

The taxpayer should select the transfer pricing method that assures the best grade of comparability between its transaction or series of transactions and the uncontrolled benchmarking data. Where possible, the comparable uncontrolled price (CUP) method should be used to establish an arm's-length price, making use of available comparable price information.

Availability

There are several commercial databases available that contain (financial) information about Portuguese companies.

The tax authorities have been using information available from their own sources (i.e. information that is not publicly available but obtained from CIT returns and governmental tax audits). Recently, the tax authorities acquired AMADEUS, a financial database, to assess the compliance of controlled transactions with the arm's-length principle.

In January 1999, the tax authorities published a list of ratios determined by dividing taxable income by turnover for the various sectors recognised for commercial register purposes. The ratios are based on taxpayer information for the years 1994, 1995 and 1996. Entities that in 1998 have a ratio that is inferior to the one determined for the relevant sector would, in principle, be subject to a tax inspection. We are not aware of such a study being repeated in later years. Furthermore, it is uncertain whether the tax authorities may use such data to support proposed adjustments to taxable income because the underlying data may be considered confidential (secret comparables).

Risk transactions or industries

Transfer pricing is becoming an area of increasing focus for Portuguese tax authorities. They are notifying more and more companies to deliver the transfer pricing documentation of the recent years. In our understanding, such companies are in different types of industries, and it does not follow that the tax authorities' transfer pricing audits are focusing on certain industries or specific types of transaction. Therefore, as a general rule, all controlled transactions should be duly supported and documented in accordance with the arm's-length principle.

More recently, tax authorities have started to question the economic analyses presented in the transfer pricing documentation, among others by questioning the chosen profit level indicators and the criteria used in the benchmark searches. Moreover, we have experienced that tax authorities are asking for detailed information and documentation underlying intragroup services, such as management fees, royalties, cost contribution arrangements, transactions with entities that are resident in low tax jurisdictions and group financing.

Limitation of double taxation and competent authority proceedings

In principle, transfer pricing adjustments should be implemented so as to avoid double taxation.

When the adjustment is between two resident associated enterprises, it is mandatory that the tax authorities perform the corresponding adjustment.

When the adjustment affects transactions between a Portuguese company and a non-resident, the mechanisms laid down in the relevant double taxation treaty should be applied. Where the non-resident is within the EU, the provisions of the Arbitration Convention relating to the elimination of double taxation (EC Directive 90/436) may also be applied.

Advance pricing agreements (APAs)

The Ministerial Order 1446-C/2001 stipulated that after relevant experience would have been gained regarding the application of the new transfer pricing rules, the Portuguese tax system would be in a position to adopt the OECD's recommendations in the area of APAs. The state budget for 2008 introduced APA rules by means of adding article 128-A to the CIT Code. This article was subsequently changed into Article 138 by decree-law number 159/2009.

Article 138, Number 9 of the CIT code stated that a Ministerial Order from the Minister of Finance would regulate the requirements and conditions for preparing and filing a request, as well as what procedures, information and documentation are to be applied in the APAs.

Detailed APA rules were introduced by the Ministerial Order 620-A/2008, which entered into force on 16 July 2008.

This Ministerial Order establishes specific regulations regarding the implementation (procedures and obligations) of the APA regime in Portugal, namely:

- The APA request or proposal should be sent to the Portuguese Tax Authorities (PTA) up to 180 days prior to the beginning of the first fiscal year covered by the agreement.
- The maximum duration of an APA (duration from APA application to final conclusion) is 300 days for unilateral APAs and 480 days for bilateral APAs.
- The conclusion of an advance agreement is subject to the payment of charges, which are determined under the terms and limits foreseen in Ministerial Order 923/99, dated 20 October 1999.
- The APA is valid for a maximum of three years with the possibility for renewal; and
- Rollbacks are not available.

Due to the fact that Portugal only recently enacted legislation concerning APAs, it is possible to obtain an APA only for the tax years starting on or after 1 January 2010.

Anticipated developments in law and practice
Recently, transfer pricing rules have been also extended to Value Added Tax (VAT) matters, in case one of the associated enterprises is not allowed to total VAT deduction. It is not expected that there will be further developments in the near future.

Liaison with customs authorities
Recently, the tax authorities and the customs authorities merged in a single authority and, therefore, it is expected that there will be increasing exchange of information between tax authorities and customs authorities.

OECD issues
Portugal is a member of the OECD. The new transfer pricing rules reflect the approach set out by the OECD Guidelines. Ministerial Order 1446-C/2001 indicates that in more complex cases, it may be advisable to consult the OECD Guidelines for further clarification.

Under a reservation made in Article 9 of the Model Tax Convention on Income and Capital, Portugal reserves the right not to insert paragraph two (regarding corresponding adjustments) in its tax treaties. The 'older' tax treaties, most of them with EU countries, do not contain a corresponding adjustment provision. However, the more recent treaties include a corresponding tax adjustment provision equivalent to the above-mentioned paragraph of the Model Tax Convention on Income and Capital.

Joint investigations
Portuguese law does not prevent Portuguese tax authorities from joining the equivalent body of another state to set up a joint investigation into a multinational company or group.

Thin capitalisation

Portuguese taxation rules for thin capitalisation were introduced in January 1996. Where the indebtedness of a Portuguese taxpayer to a non-resident entity in Portugal or in an EU country with whom special relations exist is deemed excessive, the interest paid in relation to the part of the debt considered excessive will not be deductible for the purposes of assessing taxable income.

In determining whether special relations exist, reference is made to Article 63 of the CIT code regarding transfer pricing (i.e. special relations exist if the non-resident entity has or can have substantial influence, directly or indirectly, in the management decisions of the resident entity).

Excessive indebtedness occurs where the value of the debts in relation to each of the entities is more than twice the value of the corresponding shareholding in the taxpayer's equity. Any disallowed interest is not requalified as a dividend for withholding tax purposes. This means that withholding tax should be levied on the full amount of the interest, including the interest related to the part of the loan that exceeds the 2:1 debt-to-equity ratio.

To determine the qualifying debt, all forms of credit will be considered, whether in cash or in kind, including credit resulting from commercial transactions that are overdue for six months or more. In order to determine qualifying equity, paid in share capital includes all equity capital except for unrealised capital gains or losses, including those arising from revaluation not authorised by the tax legislation, and amounts resulting from the equity method of accounting.

In cases where the 2:1 ratio is exceeded, the taxpayer may be able to avoid adjustments under the thin capitalisation rules where it can be shown that the same level of indebtedness could have been obtained with similar conditions from an independent party. Such evidence must be kept in the annual tax file of the company for 10 years. This option is not applicable where the indebtedness is towards an entity resident in a territory considered by Portuguese law as a territory with a clearly more favourable tax regime.