DOUBLE TAXATION AGREEMENTS

A Double Taxation Agreement is a bilateral treaty made between two countries to resolve issues regarding potential double taxation of income. Tax treaties determine the rate of tax that a country can apply as well as resolving potential conflicts in assessment. The purpose of the agreements between fiscal administrations is to enable tax authorities to 1) guard against international taxpayers being taxed twice on the same income and 2) share information between Tax Authorities to avoid tax evasion. Portugal currently has DTA's with 78 countries around the world.

Qualifying for relief from double taxation

Countries may reduce or avoid double taxation in one of two ways:

- The *exemption method* from taxation of foreign-sourced income;
- The international tax *credit method* for tax paid on foreign-sourced income.

The following tests must be met for foreign taxes to qualify as an international tax credit:

- The tax must be charged directly to the taxpayer;
- The tax was paid or accrued directly by the taxpayer;
- The charge must be the actual foreign tax obligation;
- The tax assessed on income (or a charge in lieu of income tax).

Foreign taxes ineligible for an international tax credit

The following are examples of some foreign taxes that do not qualify as a foreign tax credit:

- Taxes on excluded income;
- Taxes only eligible on itemized deductions;
- Taxes on persons controlling foreign companies who fail to file required information;
- Taxes paid on contributions accrued to a foreign country covered by a Social Security (*National Insurance*) Agreement.

Foreign Withholding Tax and Income Tax Treaties

The amount of foreign tax qualifying as a international credit may not be the exact amount of tax withheld at source. You may only be entitled to a reduced rate of foreign tax based on conditions outlined in the relevant double tax treaty.

Foreign Tax Credit Limit

A foreign tax credit cannot exceed total total liability. If you have foreign tax credits available but cannot use them because of limits to foreign tax credits, you may be able to carry them back to the previous tax year or forward to future tax years. Certain tax treaties have specific rules that you must consider when calculating your foreign tax credit.

Relief from foreign tax paid

For income and capital gains tax, the same rules apply when claiming foreign tax credit relief. The tax credit is the lesser of the foreign tax paid. The credit reduces the tax liability to reduce or eliminate overall double taxation. The tax liability on a specific amount is the difference between the tax due on income or capital gains.

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