DIVIDENDS
Taxation in Portugal

While one might expect that assessment of dividends to be a routine affair for *Finanças*, just the opposite proves to be the case. Legislation has changed repeatedly in recent years; Brussels has mandated change in assessment practices following EU court decisions; Portuguese tax authorities have been slow to adopt a simple, transparent system that meets both national legislation and EU principles.

Background

When assessing Company profits, taxation occurs in a two-stage process: first, the Company pays Corporate Income Tax on its *profits*, then Shareholders pay Individual Income Tax on these *distributed profits* (now called *dividends*). This assessment procedure is called "*economic*" *double taxation*. Almost all countries in the EU have adopted one of several methods to eliminate *"economic" double taxation*-some via the Company, some via the Individual. Regardless of the method, the end result should be the same: dividends reported by the Individual should be after the elimination of any*"economic" double taxation*.

Subsequently, on "in-bound" dividends (from other EU countries), *"international" double taxation* (two jurisdictions potentially taxing the same income source twice) is eliminated according to the rules of the respective Double Tax Convention (DTC).

Current Practice

To eliminate *"economic" double taxation*, Portugal has adopted the "*Half Income Tax Method*" (only 50% of included dividends received by the Individual are subject to marginal income tax rates).

If one elects to have dividends assessed independently from other income, the full dividend is taxed at a flat rate of 28%.

However, rather than seeing this *economic* double tax elimination in its full context, current Portuguese fiscal policy confuses the issue by mixing domestic and international double taxation relief.

Sometimes the approach used is as follows: *Since Portugal taxes only ½ of the income, only ½ of the international tax credit will be conceded*. On other occasions, international tax credits are tacitly conceded on aggregated dividend income but not on autonomously declared dividends, despite the fact that both reporting methods relate to "economic" and not "international" double taxation.

In other words, these inconsistent practices overlook the fundamental fact that two entirely separate and unrelated forms of double taxation are being mixed indiscriminately often with the net result of <u>negating</u> the elimination of international double taxation. While these practices are currently under review, it may be some time before policies are updated and brought into line with EU guidelines.

Different Assessment Scenarios

I. **Dividends paid by Portuguese Companies**

1) *Tributação Autónoma* - Withholding at source at flat rate of 28% (tax is final: no further reporting) or
2) *Englobamento* - Reporting together with other income at marginal rates (0 - 48%). In this case, withholding at source acts as a tax credit applied to final assessment due.

II. **Dividends paid by EU Companies**

1) Tax Withheld at source:
   a) Assessment at source is limited by Double Taxation Conventions
   b) Balance of withholding is to be refunded as per DTC procedures;

2) Elimination on "*Economic" Double Taxation* -
   2 options:

   a) *Englobamento* - declaring only ½ of Dividend together with other income taxed at marginal rates (O - 48%) or

   b) *Tributação Autónoma* - Declaring the full dividend - independent flat rate assessment at 28%; c) Elimination of International Double Taxation: apply international tax credit as per DTC;

III. **Dividends paid by Companies in other countries worldwide**

1) Reporting Income: declaring along with other income (*englobamento*);
2) Assessment: at marginal rates (0 - 48%);
3) International Double Taxation - DTC rules apply.

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