DIVIDENDS AND ROYALTIES

DIVIDENDS & DOUBLE TAXATION ISSUES

I received dividends that were taxed at source in another EU jurisdiction. Will I have to pay tax again in Portugal?

Yes and No. While you are protected from double taxation, the issues can be complex. The method of final assessment may vary depending on the source of the dividends.

Dividends: *Background*

When assessing Company profits, taxation occurs in a two-stage process: first, the Company pays Corporate Income Tax on its *profits*, then the Shareholders pay Individual Income Tax on these *distributed profits* (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 the "*economic" double taxation*.

Subsequently, on "in-bound" dividends (from other EU countries), *"international" double taxation* (two jurisdictions 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, the current Portuguese fiscal policy assumes the following logic: *Since Portugal taxes only ½ of the income, only ½ of the international tax credit will be conceded.*

In other words, this practice overlooks the fact that two entirely separate and unrelated forms of double taxation are being mixed indiscriminately with the net result of negating the elimination of international double taxation. While this practice is under review, it may be some time before current policies are updated and brought into line with EU guidelines.

Different 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 DTC's (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 to be taxed at marginal rates (0 - 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 may apply.

ROYALTIES - ASSESSMENT IN PORTUGAL

How will my royalties be taxed in Portugal?

Royalties are considered to be part of Category B, business activity. If received on an annual basis, one should register as a sole trader in the Simplified Regime when less than €100,000. For larger amounts, Standard Accounting (*contabilidade organizada*) is required. If obtained on a one-off basis, they are reported as an "Isolated Act" (*Acto Isolado*) in Category B.

How are royalties assessed when they are direct to the author?

a) **Paid in Portugal**

Royalties paid in Portugal are subject to a 5% withholding tax.

b) **Paid from Abroad**

If Royalties are paid from abroad, Double Tax Convention rules may apply. If so, tax withheld at source will be considered up to the percentage defined in the respective double tax treaty and will be eligible for an *international tax credit* in Portugal. Any additional balance withheld should be refunded by the Source Country.

How does assessment work?

For resident taxpayers who are the original authors, the first €10,000 of Royalties are entitled to a 50% exclusion. Under the Simplified Regime (when income falls below €150,000), the balance is then reported allowing for a further 30% exemption.

Non-Residents currently pay a flat rate withholding of 25% on Portuguese-sourced royalties.

Withholding for residents is at 16.5%. Alternatively, this income is added to other sources to determine the final tax rate.

Reported as income from abroad (*Anexo J*), it is not necessary to register the activity. If tax is deducted at source on foreign royalties, Portugal grants a tax credit up to the limit as defined in the appropriate Double Tax Treaty.

Example: Mr. Smith received €55,000 in Music Royalties in 2016 to which he is entitled to a 50% exclusion (up to a maximum of €10,000), leaving a taxable income of €50,000. As part of the Simplified Regime, he was subsequently taxable on 95% of this amount or a net of €47,500. This amount is added to other sources of income in order to determine final assessment at marginal rates.

(*Reported as income from abroad in Category B, he is not required to register as a business activity nor pay Social Security Contributions*.)

What happens when royalties are paid to a third party?

If royalties were originally bought from the author and now received by a third party, the full income is taxable with no exclusions. If withholding takes place, it will be at the rate of 16.5% for residents and 25% for non-residents as a final payment.

While reported on Annex B as business income, no prior registration is required nor will this income trigger mandatory Social Security contributions in Portugal.

How am I taxed if I sell royalty rights?

The sale of royalties is taxed in Category G (Capital Gains). The full gain is taxable at 16.5 % to Residents and 25% to non-residents.

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