



Real Estate Investment in Portugal

THE LEGAL PERSPECTIVE

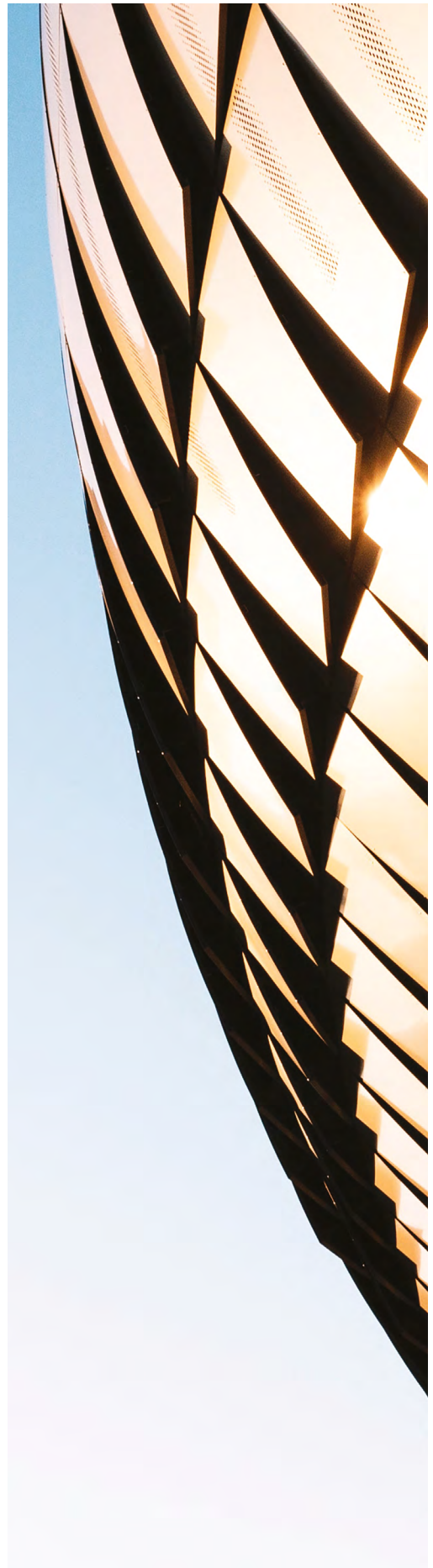
Introduction

In recent years, Portugal has become an attractive market for investment in real estate. The market has seen huge growth in the volume of transactions during that time, particularly in Lisbon. This has been facilitated by the golden visa program, which allows citizens of non-EU Member States to apply for a residency permit, subject to certain conditions, one of which is a minimum investment in real estate of EUR500,000 or EUR350,000 in some special cases and also as a result of Europe-wide tax reforms which have placed Portugal in the spotlight for investors aiming to benefit from the tax regime pertaining to non-residents. Additionally, as the economy has improved, national investors have also regained access to credit, which has in turn enhanced the ability to finance real estate transactions. Furthermore, in 2015 significant changes in the tax treatment of collective investment entities, including real estate investment funds incorporated either as corporate funds or as contractual funds, came into force and this has served as a further boost to the market.

An additional boost has been provided by the influx of tourists from around the world to both Lisbon and Oporto, which combined with the coming into force of a regime allowing owners to offer short term leases, has created a great opportunity for investors aiming to obtain a significant return on investment.

The stability of the real estate market along with a large inclination among market players to embrace foreign investment has made Portugal, and particularly Lisbon, an attractive place in which to invest.

Investors around the world want to have a clear idea of the acquisition process and the relevant tax implications arising in connection with these transactions and ongoing ownership. Accordingly, we have prepared this real estate investment guide to allow investors to assess the regime and to obtain an overview of the legal issues involved with property acquisitions in Portugal. If you have any further questions, please contact our Lisbon Real Estate team.



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1. Ownership of real estate

1.1 Full ownership

Full ownership consists of a complete and exclusive right to possess, enjoy and dispose of an interest in property. However, this may be subject to limitations arising from specific public statutes (including development plans).

An interest in property may be vested in a sole owner or multiple owners and, in the latter case, a co-ownership regime in accordance with the terms of the Civil Code will apply. This regime contains specific rules for property management and also contains rights that will be triggered in the event of disposal, such as pre-emption rights in favor of the other co-owner(s).

In order to create a more than merely contractual right and ensure an interest in real estate is binding on third parties, an interest in real estate must be registered in the Land Register.

1.2 Surface right, usufruct and right of use

A surface right is defined 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 surface right can be established for a limited period of time or be granted in perpetuity.

Usufruct 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. The beneficiary is entitled to use the property as if he was the owner.

The right of use is a right to use a property owned by a third party under certain terms and conditions.

In all of the above cases, in order to have effect vis-à-vis third parties, registration in the Land Register is required.

1.3 Condominium

This is a concept used in connection the legal organization of a building which is legally and physically divided into several units. The introduction of a property into this regime must be effected by means of a public deed and typically will occur at the same time as the owners approve the condominium regulations. The condominium regulations contain the terms and conditions

for the use of the common areas and set out the rules for the management of the property.

Additionally, they may contain a regime to determine the amounts for maintenance of the property and payment of costs attributable to each part of a property for items used in common. It is always possible to amend and alter the condominium regulations, although depending on the subject matter of any proposed amendment a specific majority or unanimity may be required.

The deed incorporating these regulations and provisions must be duly registered in the Land Registry.

1.4 Restrictions on ownership by foreigners

Foreign investors are not subject to any limitations on the acquisition of real estate. On the contrary, Portugal has adopted several measures to encourage and attract foreign investment, such as the establishment of a residency permit program (commonly referred to as Golden Visas) and a more favorable tax regime when compared with other EU countries.

2. Acquisition of ownership

2.1 Formal requirements

Since 2008 any agreement for the transfer of property can be undertaken by private contract. This is subject to certification of the signatures of both the seller and buyer, in accordance with specific statutory requirements. Contracts for the sale of property may be executed by legal representatives on behalf of their clients subject to compliance with mandatory procedures set forth by the Portuguese Bar. Transfer may also be executed by a notarial deed, and in those cases, the Notary is responsible for registering the transfer on the instruction of the purchaser.

In order to execute a deed or a private contract, the buyer is obliged to provide evidence all taxes due on the transaction have been paid. It is the responsibility of the seller to provide evidence of compliance with all formalities relating to the transaction, including evidence that all necessary communication has taken place to satisfy any pre-emption rights.

2.2 Registration

Every property is recorded in the Land Registry and all details, including a description of all transactions pertaining to an interest in property since its introduction onto the register, is available online. The Land Registry provides a code to access the online information which can also be disclosed, upon request, in English.

The Land Registry is accurate and any potential buyer may rely on its content.

2.3 Asset deals

An interest in property may be acquired directly by the buyer from the owner. This is a straightforward asset deal which requires compliance with all legal requirements including those referred to below (e.g. pre-emption rights). The sale and purchase agreement must clearly state and identify the parties, the property which is the subject of the transaction, the price and the terms and conditions for payment. Additionally, as mentioned above, the sale and purchase agreement may be executed by means of a private contract (subject to compliance with all formalities for this purpose) or via a public deed. Registration is essential to perfect ownership and to make the interest binding on third parties.

It is also usual for parties to execute a promissory sale and purchase agreement setting forth the agreed terms of the deal, prior to the execution of the deed or private contract. This interim agreement is normally used to secure the transaction while funding is being obtained and due diligence ongoing. It is advisable to register the promissory agreement and this will be entered in the Land Register as a provisional registration and may later be converted into a definitive registration upon the execution and submission of either the private contract or the public deed.

Legal advice should be obtained in connection with the drafting of the abovementioned contracts or for the review of the same. Additionally, legal advisors will typically conduct due diligence on behalf of a potential purchaser

based on the information disclosed by the seller or on additional information/documents requested for such purpose. The due diligence exercise aims to identify all liens and encumbrances that are registered against the particular property and their legal status.

Notary fees are determined by each Notarial Office, although a table detailing prices for each service is published regularly. On average, costs for executing a deed do not exceed EUR400 (ballpark figure). Costs for the execution of a deed are not determined by reference to the acquisition price. Registration costs are lower when all procedures are undertaken online as the cost will be EUR250 per property/unit.

Prior to the completion of the transaction the buyer must pay conveyance tax (IMT) and stamp duty (*Imposto do Selo*). In principle, the transfer of real estate is exempt from VAT. IMT rates vary depending on the price paid and the purpose for which the property is acquired subject to a cap of 8%. An exemption to the rate referred above was introduced to discourage the acquisition of properties through offshore vehicles and where this takes place IMT will be levied at a rate of 10% if the buyer is a company established in a country, territory or region whose tax regime is deemed to be less onerous.

Stamp duty is levied on the price paid or on the value of the property as assessed by the Tax Authority (VPT), whichever is higher, at a fixed flat rate of 0.8%. There are some specific cases where different rates apply. For that purpose, please refer to 7.1 below.

2.4 Share deals

Property may also be acquired via the acquisition of the vehicle registered as its proprietor. Although there are other legal entities which may acquire property, there are two types of limited liability company which can be used, namely (i) a joint stock company (*sociedade anónima* – S.A.) or (ii) a limited liability company by quotas (*sociedade por quotas* – Lda.).

Where this structure is adopted due diligence includes, in addition to all information on the property, all legal considerations connected to the company and its quota or shares, as applicable. A review of the company accounts and articles of association, as well as all information regarding compliance with and discharge of tax and social security obligations must also be undertaken. In this case, comprehensive information must be collected and/or provided by the seller as the information contained in the Companies Registry is not exhaustive and not all information requires to be registered (e.g. information on board minutes and employee records, etc.).

Formalities such as pre-emption rights waivers and/or consent for the transaction must be discharged and dealt prior to the entry into

the sale and purchase agreement. This may be executed either by public deed or private contract, according to the parties' intention. Parties are also free to agree on a price mechanism for calculating the valuation of assets.

Where a share structure is utilized, IMT is only due in the event of the legal entity which owns the property is limited by quotas and if 75% or more of the company's share capital is acquired. In the event the property is owned by a joint stock company no IMT is due regardless of the percentage of share capital being transferred.

The transfer of shares or quotas does not impact on the existing arrangements at the Land Registry and thus there are no additional registration requirements. Post completion actions such as the resignation of directors and updates with regard to the Commercial Registry are required and performed prior to the entry into the sale and purchase agreement.

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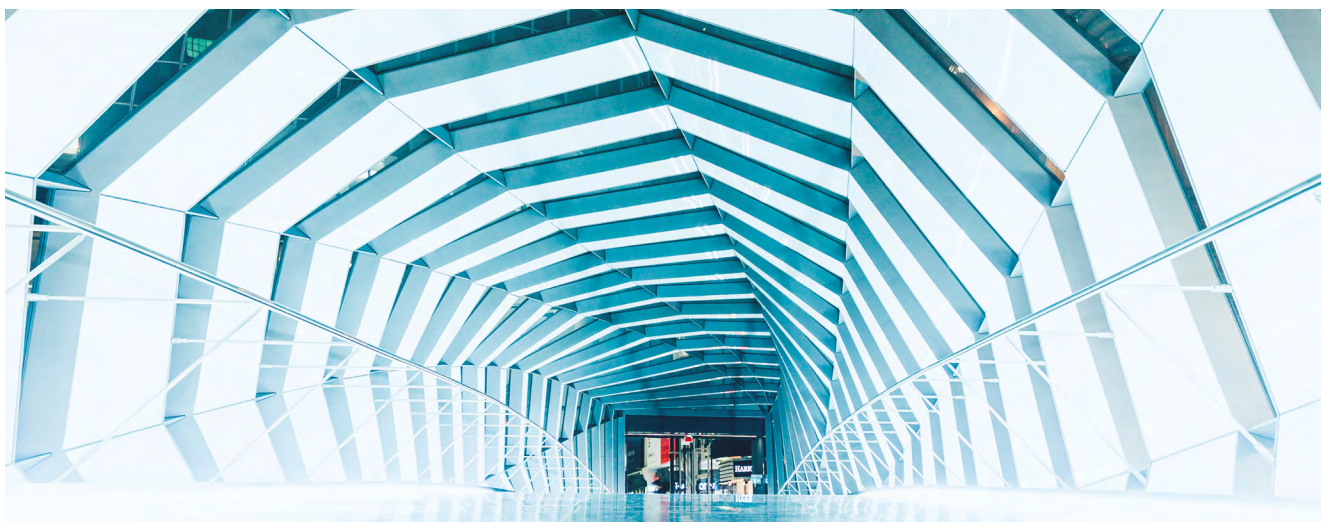
with regard to the Commercial Registry are required and performed prior to the entry into the sale and purchase agreement.

2.5 Public auctions

Properties which become the subject of public auctions are usually distressed assets following a default of its registered proprietor in relation to its creditors, tax authorities or any other instance where the property has been provided as security.

In view of the complex nature and specific requirements of the auction process, a prospective buyer would be advised to obtain legal advice on the process, including ascertaining the legal status of the property, and whether there any liens or encumbrances that may be subsisting or affect the property.

It should be pointed out that public auctions due to their complex nature are not the preferred method among commercial parties for acquiring and disposing of assets although the regime is being used by local authorities for disposing of properties located in conservation areas subject to the requirement for the purchasers to procure renovation works within a specific timeframe.



3. Other rights to property

3.1 Mortgages and charges

Mortgages are the most common form of charge. They can be voluntary or legal depending on the reason for their 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.

Another form of charge that may also be used is the encumbrance which arises by the act of a creditor initiating a legal procedure for the payment of an existing debt.

The debtor's assets are subject to an encumbrance (via a legal procedure filed with the relevant court), which will be registered at the Land Registry and evidenced by provision of the land registry certificate.

In order to be enforceable and to have effect vis-à-vis third parties, mortgages and charges must be registered and evidenced by the land registry certificate. There are specific rules which apply for registration in the event that the owner has suffered an insolvency event. In these cases, registration of securities such as mortgages granted for the benefit of the government, local authorities or in favor of the Department of Social Security may be declared void if the registration occurred less than two months prior to the insolvency proceedings. Other mortgages can also be declared void if the registration is not completed on the date of the relevant insolvency ruling.

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

3.2 Easements

Under Portuguese law, properties may be encumbered in favor of the neighboring property by the establishment of easements such as rights of way, rights of use and restrictions on use, prevention of development, etc.

All easements must be registered at the Land Registry in order to be enforceable. Depending on the type of easement a specific form may be required, although for most cases a private contract with the signatures duly certified will suffice.

3.3 Pre-emption rights

Pre-emption rights may arise either by legal prescription or via agreement between the parties. Examples of legal pre-emption rights are:

- co-ownership: if one co-owner intends to sell its part, the other co-owners will have a pre-emption right;
- owners of rural plots of land may have pre-emption rights for the sale of adjoining properties;
- public entities may have pre-emption rights for the acquisition of properties which are classified as assets of special historic and/or architectural value;
- local authorities have pre-emption rights for certain types of transaction which involve dealings in real estate within their jurisdiction;

- tenants which have been granted a lease for a term of more than three years benefit from pre-emption rights in the event of sale of the leased property.

Apart from the legal pre-emption rights contained in the Civil Code, parties are free to create other pre-emption rights by agreement, although those rights cannot act in priority to legal pre-emption rights. In the event that such a pre-emption right is granted, it will be necessary to execute a deed and to register this with the Land Registry in order for the right to be valid and binding on third parties.

3.4 Options

Options may be agreed and granted to third parties by the owner of the property. The option must be formalized via a unilateral contract and registered in the Land Registry to be legally binding.

3.5 Overage

Overage provisions are typically found in contracts for the use of units in shopping centers in order to assess the rent payable. Although the Contracts for the Use of Stores in Shopping Centres regime has not yet come into force, the regime has proved to be an alternative to non-residential contracts when applied to a commercial space within and forming part of a multi-let commercial property which is managed by a property management company.

4. Zoning and planning law permits

Zoning and planning in Portugal is mainly governed by a planning policy, enacted by Decree Law No. 80/2015, of May 14, 2015. All plans are binding on public bodies, and in addition individuals are subject to the requirement of special plans and municipal plans. The relevant urban plan will prescribe whether a landowner may construct a new building or refurbish an existing building. The parameters and conditions contained in these plans for urban areas are applicable in the construction, alteration, extension and demolition, and will also determine the uses permitted.

The design and appearance of a new building may be governed by public law if a detailed plan or an urbanization plan has been approved for the area. However, the design and

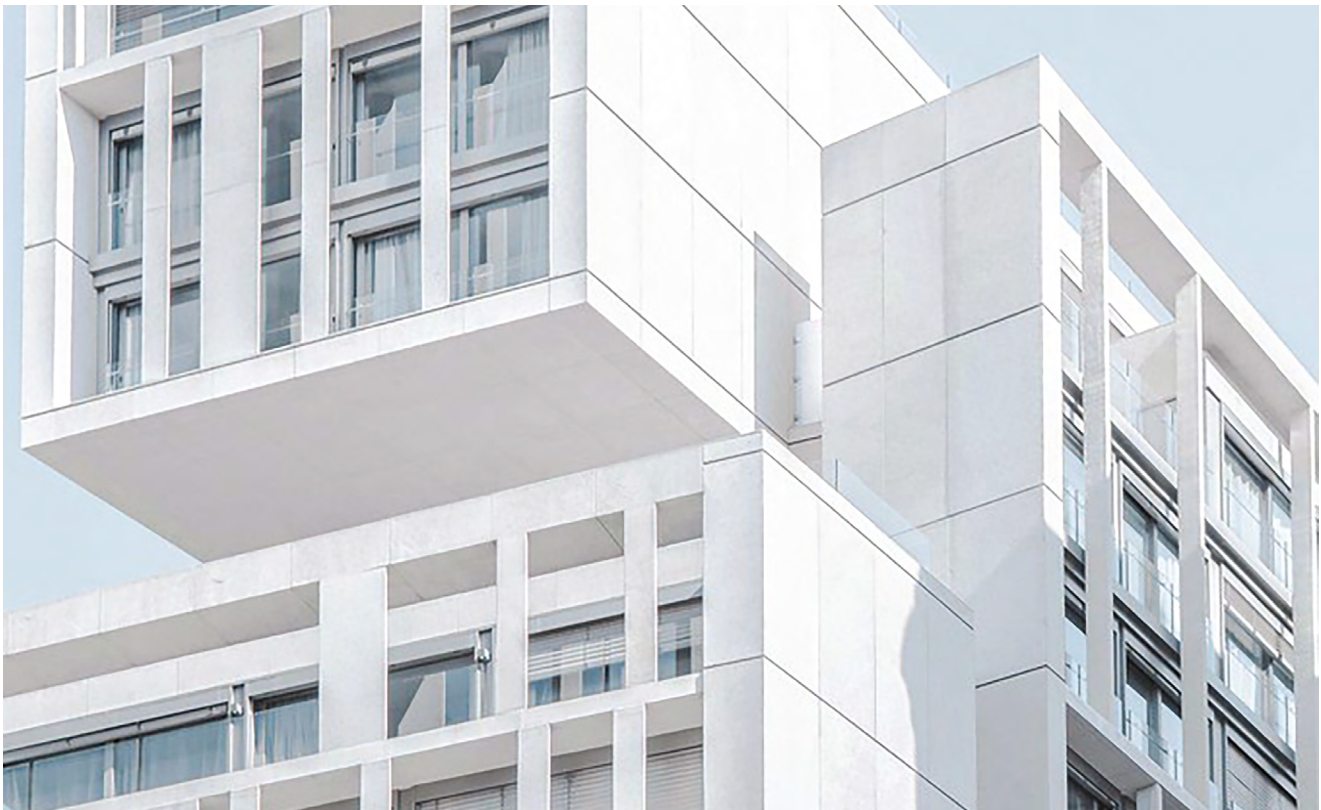
appearance of a new building will not always be the sole preserve of public law. The method of construction is governed by building regulations such as the General Regulations of Urban Buildings – *Regulamento Geral das Edificações Urbanas* – dating from 1951.

Municipal plans for land planning determine the permitted use of development land according to the sector (housing, commerce and services, industry, agriculture, etc.). Special plans (detailing protected areas, coastline, public reservoirs, estuaries and archaeological parks) define unauthorized, conditional and preferred uses.

The main relevant administrative authorities are the Municipalities (local authorities). The Municipalities draw up and approve the municipal

plans for land zoning and are the authorities which have the power to conduct control procedures for any development scheme.

A construction permit is required to undertake a development which involves the erection of a building or significant alteration of an existing one. Depending on the nature of the project and the proposed use, specific planning conditions may be imposed, including in relation to the architectural nature of the project. In order to implement industrial, tourist and commercial projects, other specific authorisations/licenses are required.



5. Environmental liability

In Portugal, the environmental law framework that governs construction developments reflects European Law principles. The main statutes are: Law No. 19/2014, of April 14, 2014 and Decree Law No. 151-B/2013, of October 31, 2013. There are also other relevant statutes on:

- waste management;
- noise pollution;
- air quality;

- the use of water areas;
- water quality;
- specially protected areas (such as national parks and national reserves);
- ecological and agricultural reserves; and
- energy certification of buildings.

Public and private projects which may be deemed to have detrimental effects on the environment are

subject to an environmental impact assessment. Depending on the area where such projects are to be carried out, specific requirements regarding decontamination of the soil may be in place.

It is very important to conduct specific due diligence in connection with the environmental search of the proposed site and the surrounding land.



6. Leases

6.1 Duration

The length of a non-residential lease is determined by agreement between the parties, with a maximum limit of 30 years. Absence of a specific term means that the contract shall be deemed to be in force for a five-year term and the tenant may only terminate on giving prior notice of at least one year. A residential lease is subject to the same maximum period with the difference from a non-residential lease being that a tenant may only terminate on giving prior notice after one-third of the initial term of the contract or the term thereof has elapsed and with a pre-notice of 120 or 60 days, if the contract shall be deemed to be in force for a one-year term or over or for less than a one-year term.

Portuguese leasing law was formerly very protective towards tenants but has evolved to a more balanced position.

Recent changes to the law on leases have provided scope for the landlord to terminate a lease (either for residential or non-residential) or to initiate a rent review provision so that the rent payable reflects current market conditions. Scope to vary the lease may also be utilized so as to incorporate the more balanced regime which now applies and ensure that the lease is not subject to the more protective regime for tenants which formerly existed.

6.2 Rent

Rent is usually calculated by reference to a sum per m² of the area let. Typically, rents are payable in advance on a monthly basis.

Rent is normally charged free of VAT. However, subject to satisfaction of certain requirements, it is possible to ask the Tax Authorities for a waiver from the exemption from VAT.

The landlord may request the waiver and charge VAT in order to recover sums of VAT incurred on landlord expenses in connection with the property. The tenant must also be a VAT taxable person for the tax waiver from the VAT exemption to apply. The current VAT rate for leasing purposes is 23%.

6.3 Rent review

A rent review shall be undertaken in accordance with the legal annual coefficient approved by the government. However, parties may also agree other criteria for rent review.

The landlord may operate additional rent reviews in older leases (non-residential leases granted before 1995 and residential leases granted before 1990), where the rents are very low. Law 31/2012 provides scope for negotiation between the parties in order to agree a new rent which reflects the current market. If the parties do not reach agreement, the rent is reviewed in accordance with a formula provided by statute to the effect that the annual rent is to be equal to one-fifteenth of the property's tax value.

6.4 Operating expenses

The tenant is responsible for the payment of charges and expenses for the supply of goods or services related to the property (for example: water, electricity, gas, telephone, and internet). The tenant is only responsible for other expenses if it is expressly agreed between the parties.

The landlord is responsible for the payment of the water rates, insurance fees, council tax and stamp duty due on the grant of the lease.

Unless otherwise agreed, the landlord is responsible for repair of the property. It is usual for the landlord to be liable for any cases of extraordinary repair that may be undertaken, and for the tenant to be responsible for the ordinary repair costs.

6.5 Maintenance, repair and reinstatement at end of lease

The tenant is only permitted to carry out the works when the lease allows so, or where the landlord has given their prior written consent (except in emergencies). In the case of emergency, the tenant may carry out the works and has the right to recover the expenses of doing so and offset these expenses against the rent due. However, the tenant may (and is under an obligation to) carry out minor repairs to the property to ensure that it remains adequate for its intended purpose.

Should the tenant carry out improvements to property they shall be entitled to receive compensation or remove these improvements provided their removal does not cause damage to the property unless otherwise agreed.

The landlord is responsible for the repair and maintenance of the common parts of the building in which the property is located, except if otherwise agreed in the lease.

Typically leases provide that premises shall be let in a condition fit for purpose for which they are intended (subject to fair wear and tear).

6.6 Assignments/transfers

As a general rule, transfers of leases to a third party require the landlord's consent. Non-residential leases may be transferred by conveyance without the landlord's consent subject to notification to the landlord and a pre-emption right unless otherwise agreed.

The transfer of a going concern does not require the landlord's consent, but the landlord should be notified within one month.

Generally the parties will provide for these matters in the lease. Where consent is not required, the parties normally limit the scope for the tenant to deal with the lease, for example by prohibiting assignment to a group company.

6.7 Subleases

The tenant cannot sub-let the property, either in whole or part, without the landlord's prior

written consent, which is a valid condition of the sub-leasing. Should subletting occur without this being obtained, the landlord may terminate the contract based on the tenant's default.

6.8 Termination

The landlord can only terminate the contract before the end of the term in the event of tenant default. The law sets out some of the grounds on which the landlord may terminate. In addition to these grounds, the landlord may specify others which will be deemed to be an event of default.

The landlord may terminate the lease upon written notice to the tenant, without needing to take legal action where the reason for termination is non-payment of rent for a period equal or superior to three months after the due dates, failure to pay charges or expenses, or the tenant refusing to cooperate with undertaking works required by a public body. The landlord may also terminate the lease if the basis for termination is a delay in the payment of the rent, for more than eight days, on more than four

occasions, whether or not running consecutively, within a period of 12 months.

Non-residential leases are more flexible and parties may set out specific break options during the term of the lease including a right for the landlord to terminate the lease prior to the end of the agreed term.

6.9 Sale of leased property

The sale of a leased property does not affect the lease and all rights and obligations of the previous owner are transferred to the new owner. However, in the event the lease has been granted for a term of more than three years and once three years have elapsed the tenant has a pre-emption right in the transaction and must be notified of the sale and purchase agreement in order for it to assess if it intends to exercise the pre-emption right.



7. Tax

7.1 Transfer tax, stamp duty and land tax

The tax treatment of a transaction will be determined according to whether it is structured as an asset or share deal. In the case of an asset deal Municipal Property Transfer Tax (IMT) will be calculated on the purchase price paid or on the VPT (value of the real estate assessed by the Tax Authority), whichever is higher.

IMT is charged at the following rates:

- A flat rate of 6.5% on the sale or transfer of any urban property not used for exclusively residential purposes.
- A flat rate of 5% for rural properties.
- Progressive rates on the sale and transfer of urban buildings or apartments used exclusively for residential purposes that are intended to be the buyer's permanent residence, ranging from 0% to 6%.
- Progressive rates on the sale and transfer of urban buildings or apartments exclusively for residential purposes and/or intended for letting purposes, but not intended as the buyer's permanent residence, ranging from 1% to 6%.

The transfer of property is also subject to Stamp Duty at a flat rate of 0.8%. Stamp Duty will be calculated on the price of the transaction or on the VPT, whichever is higher.

In the case of a share deal, IMT only applies on the purchase of shares in a private limited liability company (or in a privately placed closed-end real estate investment fund) holding real estate assets. IMT will be due if, following the transaction, one shareholder become holder of 75% or more of the company's total equity, or the number of shareholders is reduced to two married or unmarried partners.

If the purchase of shares involves a joint stock company, the transaction is not subject to IMT or Stamp Duty. The same also applies to the purchase of a shareholding in a private limited liability company if the holding represents less than 75% of the total share capital.

In both cases – asset deals and share deals – the buyer is responsible for the assessment and payment of IMT. IMT must be paid prior to completion and the notary is obliged to confirm payment.

Stamp duty, where applicable, is paid by the buyer (who normally also pays the notary's fees) before the public deed of transfer is signed.

A charge to IMT is also triggered where real estate assets are transferred as payment in kind against the value of participation units of closed-end real estate investment fund and when real estate is given as reimbursement of participation units where the fund is liquidated. This charge will also occur where referred funds are merged.

7.2 Value added tax

Although as a rule the transfer of property and shares in Portugal is exempt from VAT, it may be applicable in the case of transfer of property. In this case, the seller may waive the exemption if certain conditions have been met and the operation of the waiver is subject to compliance with several formalities.

If the exemption is waived, VAT can be recovered in accordance with specific provisions set out in the Portuguese VAT Code.

7.3 Other real estate taxes

IMI is a municipal property tax, payable by the owner or the person entitled to use the property (excluding tenants), assessed on the VPT (value of the real estate assessed by the Tax Authority) for urban and rural properties.

IMI is payable on the VPT of each property at rates ranging between 0.3% and 0.45% (for urban properties) depending on the rules of the region in which they are situated. For rural properties a rate of 0.8% applies.

Urban properties to be used solely for residential use by the buyer, as their family primary domicile, may benefit from a temporary exemption from IMI for up to three years, if the property's value is less than EUR125,000. To benefit from this exemption, the buyer's income for personal income tax purposes in the previous year cannot exceed EUR153,300.

Exemptions from IMI are also available in the case of projects of economic importance, for developments carried out for the purposes of tourism, buildings classified as being of national, public or local interest and buildings subject to rehabilitation (specific legal rehabilitation criteria must be observed).

IMI is borne by the owners of property and is collected by the local authorities according to the valuation of the property determined by the tax authorities.

For real estate owned through a company established in a country, territory or region whose tax regime is deemed to be clearly less onerous the rate is 7.5% per year.

7.4 Taxation of rental income from real estate

Rents and the profit from sales of property (that can be treated as profit or capital gain) are the main methods by which income can be generated from ownership of real estate.

Rents from urban, rural or mixed-use properties are classified as taxable income for the purposes of Portuguese Corporate Income Tax (IRC). If the investor is a private individual rents will be treated as taxable income for Personal Income Tax (IRS) purposes.

Whether generated through an onshore corporate entity, an onshore permanent establishment in Portugal or a vehicle with no permanent establishment, rents from real estate located in Portugal are always subject to Income Tax.

(i) Indirect investment through a corporate entity.

The income of resident corporate taxpayers is subject to IRC at a general rate of 21% (on the Portuguese mainland). A reduced rate of 17% may be applicable to the first EUR15,000 of taxable income if the company is qualified as a micro, small or medium company, meaning that it has fewer than 10, 50 or 250 employees respectively and its annual turnover or annual balance sheet does not exceed, respectively, EUR2 million, EUR10 million or EUR50 million.

The income of resident corporate taxpayers may also be subject to a municipal surcharge of up to 1.5%, which is levied by many Portuguese local authorities.

A state surcharge is also applicable at rates ranging between 3% and 9% when the corporate taxable income is higher than EUR1.5 million. Taxable income for IRC purposes is calculated on the basis of the net accounting profit as adjusted for tax purposes.

A corporate entity is entitled to deduct costs related to maintenance and repairs, general costs and municipal property tax (IMI), and other specific costs such as those incurred in connection with the construction or acquisition of the property and depreciation (excluding land).

(ii) Direct investment through a permanent establishment.

Income attributable to a vehicle incorporated in Portugal is liable to IRC in the same way as a Portuguese-resident company at the same rate as that applicable to resident corporations.

(iii) Direct investment without a permanent establishment.

If the investor does not have a vehicle incorporated in Portugal, Income Tax is only payable on income generated in the territory.

Income derived from rents is subject to Corporate Income Tax at a rate of 25% for non-residents. As to the Personal Income Tax, the rate is 28%.

The costs, which may be tax deductible are those related to municipal property tax (IMI) and maintenance and repair expenses incurred in relation to the leased property.

A withholding tax may apply to non-resident individuals or corporations, if the lessee is an entity required to have audited accounts in Portugal. This would usually be the case with a commercial lease.

Foreign investors carrying an activity in Portugal must file an annual tax return with the Portuguese Tax Authority (and where that party is not an EU resident, this must be done through an appointed tax representative).

7.5 Taxation of dividends from a company owning real estate

In Portugal tax may require to be withheld on the distribution of dividends to shareholders. Tax withheld (if mandatory) may be done so on a provisional basis for residents and permanently for non-residents. This depends on the investor's status as follows:

7.5.1 PORTUGUESE-RESIDENT CORPORATE SHAREHOLDERS PROVISIONAL WITHHOLDING TAX

Distributions of dividends to corporate shareholders resident in Portugal may be made without withholding tax if the participation exemption regime applies.

If the shareholder has its registered office in Portugal (i.e. is a Portuguese corporate entity) or if its management is located in Portuguese territory then it is deemed to be resident for tax purposes. In such cases (i.e. when the participation exemption regime does not apply) a 25% withholding tax applies and the amount received as dividends is also taken into account in determining the taxable profits of the Portuguese-resident corporate shareholder for the relevant accounting period.

Definitive taxation

Distributions of dividends to Portuguese-resident corporate shareholders are exempt from IRC subject to certain conditions. The more notable conditions are as follows:

(i) the taxpayer holds shares representing at least 10% of the share capital or voting rights of the entity distributing the

dividends; (ii) the relevant holding is maintained continuously during the year prior to the distribution; (iii) the taxpayer is not within a class which falls within the tax transparency regime; (iv) the entity distributing the dividends is not exempt from IRC or any identical tax at a rate not lower than 60% of the Portuguese tax (for 2017 this will be 12.6%); (v) the entity distributing profits is not resident in a country, territory or region whose tax regime is deemed to be clearly less onerous. If the above conditions are not met, the amount received as dividends is also taken into account in determining the taxable profits of the Portuguese resident corporate shareholder during the relevant accounting period.

The income of resident taxpayers is subject to IRC at a general rate of 21%. A reduced rate of 17% may be applicable to the first EUR15,000 of taxable income (if the company is recognized as a micro, small or medium company). To be recognized as such, the company must have fewer than 10, 50 or 250 employees respectively and its annual turnover or annual balance sheet total must not exceed respectively EUR2 million, EUR10 million or EUR50 million.

The income of resident corporate taxpayers may also be subject to a municipal surcharge of up to 1.5%, which is levied by many Portuguese local authorities.

A state surcharge is also applicable at rates ranging between 3% and 9% when the corporate taxable income is higher than EUR1.5 million. Taxable income for IRC purposes is calculated on the basis of the net accounting profit as adjusted for tax purposes.

7.5.2 CORPORATE SHAREHOLDERS NOT INCORPORATED IN PORTUGAL (PERMANENT WITHHOLDING TAX)

Profits distributed by a legal entity which is tax resident in Portugal (meaning the entity is not exempt from taxation and is not a tax transparent entity), are exempt from IRC if the shareholder is resident (i) in a Member State of the EU; or (ii) in an EEA country which has agreed to cooperate on administrative matters; or (iii) in a state with whom a DTA has been entered into. Besides the requirements as to tax residency of the shareholder, further conditions need to be satisfied, notably; (i) the taxpayer must hold shares representing at least 10% of the share capital or voting rights of the entity distributing the dividends before the dividends are made available; (ii) the referred holding must be maintained continuously during the year prior to the distribution; (iii) the entity distributing the dividends must not fall within the tax transparency regime; (iv) the shareholder must be subject to and not exempt from a corporate income tax mentioned in the EU Parent Subsidiary Directive, or, when the shareholder is a resident in a EEA country, to a corporate income tax similar to IRC, at a rate not lower than 60% of the Portuguese tax.

Additionally, profits distributed to a company deemed to be tax resident in Switzerland are exempt from IRC in the terms set out in article 15 of the EU-Switzerland Agreement if (i) the company to which the profits are distributed holds directly at least 25% of the share capital of the distributing company, for at least two years; (ii) in the terms set out in the DTAs entered into by Portugal

and Switzerland with third countries, the company is not deemed to be tax resident in that country; (iii) neither company benefits from an exemption on its Corporate Income Tax and both companies are limited liability companies.

If the above requirements are not satisfied, 25% of any dividend paid must be withheld by the Portuguese corporate vehicle except where the provisions of a DTA are deemed to apply.

Most of the DTAs entered into by Portugal, following the OECD Model Treaty, provide that the applicable Portuguese withholding tax rate on dividend or profit distributions cannot exceed 15%. This may be reduced to 10%, depending on the percentage of the shareholding in the corporate vehicle.

Dividends paid to shareholders established in a country, territory or region whose tax regime is deemed to be clearly more favorable will be subject to withholding tax at a rate of 35%.

In the case of a real estate investment fund, a withholding tax of 10% on the unit income distribution of dividends will be applicable for non-resident unit holders without a PE in Portugal.

The 10% withholding tax rate will not be applicable when:

- (i) the beneficiary of the unit income is established in a country, territory or region with a tax regime deemed to be clearly more beneficial;
- (ii) the income is paid or made available in accounts in the name of one or more holders but on behalf of an unidentified third party;

- (iii) the beneficiary of the unit income is a non-resident company more than 25% owned, directly or indirectly, by a Portuguese resident (company or individual). However, this shall not apply when the beneficiary is an entity resident in an EU country or EEA country which is bound by tax administrative matters or in a country with whom a DTA has been entered into.

In such cases a withholding tax at fixed rates of 25%, 28% or 35% (depending on several conditions) shall apply.

Dividends deposited in accounts of trustee entities on behalf of undisclosed third parties, will be subject to withholding tax at a rate of 35%.

7.6 Taxation of capital gains on real estate

A corporate vehicle established under Portuguese law is subject to IRC at a rate of 21% plus surcharges up to 9%. The relevant amount of capital gains arising from the sale of real estate, for IRC purposes, is obtained by deducting specific losses and costs related to the assets in hand and should be taken into account in the determination of taxable income.

Additionally, there are provisions for a specific reinvestment regime which allows that only 50% of the value of the capital gains is to be taken into account when determining the taxable income, provided the realization value is reinvested in the acquisition of specific types of assets, set by law.

A permanent establishment is taxed on capital gains or business profits arising from the disposal of real estate in the same way as a Portuguese corporate vehicle.

Capital gains or business profits from the sale of real estate held by entities with no head office or place of effective business management or permanent establishment in Portuguese territory are subject to IRC at a flat rate of 25%. For IRS purposes, capital gains are taxed at a flat rate of 28%.

7.7 Taxation of capital gains from the disposal of shares in a company owning real estate

The following rates of taxation apply on capital gains of non-residents generated from the disposal of shares in a Portuguese-based property company incorporated in Portugal:

- 25% for corporate entities; and
- 28% for individuals (however, only half of the capital gain will be taken into consideration for tax purposes if the company whose shares are sold is recognized as a micro or small company).

Certain exemptions from Portuguese capital gains tax arising on the sale of shares by non-Portuguese-resident individuals or entities are available. However, these do not apply to the disposal of shares in Portuguese-resident companies where more than 50% of the company's assets consist of real estate assets located in Portugal, or of shares in holding companies in which a company affiliated to or controlled by it holds more than 50% of its assets in real estate assets located in Portugal.

7.8 Real estate funds

Decree-Law No. 7/2015 of January 13, which came into force on July 1, 2015, has introduced a new tax regime for collective investment undertakings (UCI), and applies to the following entities: (i) Securities Investment Funds

(SIFs); (ii) Real Estate Investment Funds (REIFs); (iii) Securities Investment Companies (SICs); (iv) Real Estate Investment Companies (REICs).

Following a major trend in investment vehicles' tax regimes in Europe, this law adopts the exit taxation method, whereby the income is taxed not at the REIF level but instead at investor level.

Non-resident investors without a vehicle incorporated in Portugal (PE) will remain exempt from Portuguese taxation in respect of income derived from Securities Investment Funds/Companies (with some exceptions as described below).

However, for income derived from REIFs and REICs, non-resident investors without a local PE will be subject to a Portuguese withholding tax at a rate of 10%.

Income deriving from real estate investment funds' units and from real estate investment companies' shares shall be classified as income deriving from property for the purposes of this regime.

The fiscal regime governing real estate investment funds can be summarized as follows:

Taxation of REIFs:

REIFs will be subject to IRC at a rate of 21%. The taxable income for these purposes will be calculated as the net income, excluding capital income, capital gains, rental income and related costs incurred, as well as income and expenses relating to management fees and other commissions earned by UCIs.

Tax losses may be carried forward for a period of five years (for tax losses registered in the after January 1, 2017. Tax losses for previous periods must be subject to an individual analysis).

Exemption from the local authority surcharge (*derrama municipal*) and state surcharge (*derrama estadual*).

Mergers, demergers, or subscriptions in kind between UCIs may benefit from the tax neutrality regime in the IRC code. This will allow a more efficient restructuring operation or the transfer of assets between investment vehicles.

Taxation of Investors:

Resident investors:

- Individuals shall be subject to IRS at a withholding tax rate of 28%. The withholding tax will be final where income is not obtained under a commercial, industrial, or agricultural activity. This will not apply where these investors choose to pool their income, in which case the general progressive tax rates (from 14.5% to 48%) and the IRS surcharges shall apply.
- Corporate investors are subject to IRC at a provisional withholding tax rate of 25% (unless the relevant beneficiaries are exempt from withholding tax).
- Non-resident investors who receive income deriving from distributions by real estate investment funds or by real estate investment companies shall be subject to withholding tax at the rate of 10%.

- Non-resident investors who (i) fail to present proof of non-residence in Portugal; (ii) are established in a country, territory or region whose tax regime is deemed to be clearly more favorable; or (iii) entities in which Portuguese residents hold more than 25% of the share capital either directly or indirectly, shall be subject to withholding tax at the fixed rates of 25%, 28% or 35% (as applicable) – determined by the applicable regime in place for resident investors.

Certain reductions in the rates of Municipal Property Transfer Tax (IMT) and Municipal Property Tax (IMI) may also apply:

- Subject to autonomous tax rates (*taxas de tributação autónoma*) set forth in Article 88 of the IRC code – up to 50%.
- UCI's Income is not subject to withholding tax.
- Subject to the obligations contained in the IRC code, to enable organization of accounting systems and tax administration.
- Stamp duty will be payable on the global net asset value of an UCI and this is due on a quarterly basis. The tax rates are the following:
 - 0.0025% for UCIs investing only in money market instruments and deposits; and
 - 0.0125% for other types of UCIs (including real estate funds and companies).



8. Real estate finance

8.1 Interest rate risks

Raising of finance for the acquisition of property or for refinancing debt can be done by way of long-term or short-term loans. Where a fixed interest rate is not agreed there is always the risk of interest rate fluctuation which might be hedged via derivatives or interest rate-swaps. One of the most common types of interest rate swap is the plain vanilla swap and is available from a financial institution. In this case, the borrower agrees to pay a fixed rate to the counterparty, while receiving a floating rate indexed to a reference rate. This plain vanilla swap aims to mitigate the risks arising from any rise in the interest rates.

8.2 Assets held as security

Loan agreements are typically granted with real estate being used as security. A mortgage is granted over the property for this purpose. As mentioned above, to be valid the mortgage must be registered at the Land Registry, and this will usually be done by filing the mortgage deed.

8.3 Further collateral agreements

Share/interest pledge agreement: shares and interest pledges can be used as security for loans. The execution of a share pledge can be effected by means of a private contract, although it is necessary to find out if there are any restrictions or further requirements relating to the execution of this type of contract under the articles of association of the company.

Bank account pledge agreements: bank account pledges as security are permitted and are commonly used to guarantee specific agreements. The terms of the pledge including the right of the pledgor to access the bank account must be set out in the written agreement between the parties.

Assignment of rents: under this agreement all sums receivable in connection with the grant of a lease are assigned in favor of the lending institution. It is also possible to execute a global assignment encompassing an assignment of all rights, claims and other sums receivable (either present or future) in connection with a transaction.

8.4 Taxation on the creation of security

Stamp duty is levied in respect of both loan agreements and guarantees.

When the loan agreement and guarantee are jointly executed and when the guarantee is ancillary to the loan agreement, this guarantee is not taxed. In this case the loan agreement is taxed at the following rates:

- 0.04% of the total amount, for each month or part of a month, for agreements with maturity of less than one year;
- 0.5% of the total amount, for loans with a maturity of one year or more, but less than five years; and
- 0.6% of the total amount, for loans with a maturity of five years or more.

When the guarantee is not ancillary to the loan agreement, it will be taxed at the following rates:

- 0.04% of the total amount secured, for each month or part of a month, for guarantees with maturity of less than one year;
- 0.5% of the total amount secured, for guarantees with a maturity of one year or more, but less than five years; and
- 0.6% of the total amount secured guarantees with a maturity of five years or more, or open-ended arrangements.

If the loan is made to a consumer, under to Decree Law No. 133/2009, of June 2, 2009, the rates are as follows:

- 0.08%, for each month or part month for loans maturing in less than one year; and
- 1% for maturities of one or more.

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