SOCIEDADE DE ADVOGADOS, SP,RL
ROGÉRIO FERNANDES FERREIRA
& ASSOCIADOS

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NEWSLETTER

PORTUGUESE TAX FRAMEWORK ON INBOUND INVESTMENT (UPDATE 2021)

SUMMARY

The Portuguese tax system presents various regimes and mechanisms to foster foreign investment, which should be considered when planning an investment in Portugal.

This newsletter presents a practical overview of the main investment options available and the corresponding tax regimes, as to provide guidance to foreign investors.

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ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

A) Tax framework of different acquisitions

The main Portuguese taxes that should be considered by a foreign (individual and corporate) investor are Personal Income Tax (PIT), Corporate Income Tax (CIT), Value Added Tax (VAT), Stamp duty, Real Estate Transfer Tax (IMT) and the Real Estate Municipal Tax (IMI).

The tax treatment of the acquisition of shares of a target company (a share deal) or the acquisition of a company's business assets and liabilities (an asset deal) comprises several differences that should be thoroughly analysed, both from a shareholder's and a target company's perspective, before concluding the relevant transaction.

In a share deal, the sale of the shareholders' participation in the target company may generate a capital gain or capital loss, which is generally calculated by the difference between the transfer value, minus transfer expenses, and the acquisition value accepted for tax purposes.

Any capital gains obtained from the transfer of shares should be considered as ordinary income of the shareholder's taxable income assessment and should be taxed within PIT (individual shareholder) or CIT (corporate shareholder).

Notwithstanding, with regards to CIT, a participation exemption regime is available, that may overcome this CIT liability. If the shareholder is a Portuguese tax resident company, the general rules may not apply, *i.e.*, the income arising from the transfer of shares may be exempt from CIT, provided that the following requirements are met:

- the shareholder holds, directly or indirectly, at least 10% of the share capital or voting rights of the company whose stocks generated the capital gain;
- the shareholder held the participation during at least an uninterrupted period of 12 months;
- the company whose shares were transferred is subject and not exempt from CIT or a similar tax, at a rate not lower than 60% of the applicable CIT rate (i.e., 12.6% in 2019). Even if this requirement is met, the participation exemption regime will not apply if (i) the company whose shares are being transferred is blacklisted as a tax

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haven by Portugal or (ii) the company's profits are subject to an effective taxation that is at least 50% lower than it should be according to the generally applicable Portuguese CIT rules;

- the company whose shares were transferred is not resident or domiciled in a black-listed country, territory or region as defined in Ministerial Order no. 150/2004 of February 13th.

This regime is not applicable to gains or losses arising from the transfer of shares in company's whose assets are represented, in more than 50%, by real estate located in Portugal, except when the real estate at stake is a part of a commercial, industrial, or agricultural activity and not the lease or purchase and sale of real estate.

Should the shareholding fulfil the requirements to qualify for the above-mentioned participation exemption, any capital losses arising from the transfer of shares should also be excluded from the company's taxable income assessment.

Furthermore, capital losses arising from the transfer of shares which benefitted from the participation exemption regime applicable to either dividends or capital gains are not accepted as deductible for CIT purposes, up to the amount of exempt dividends or capital gains obtained from the transfer of shares in that same company during the previous four years.

Through an asset deal, any capital gains or losses obtained by a company should be fully considered in the assessment of its taxable income.

However, only 50% of the gain is considered provided that the amount received is reinvested in the acquisition of fixed tangible assets, intangible assets, or non-consumable biological assets.

Additionally, gains obtained by non-resident companies, without a permanent establishment in Portugal to which the gains might be allocated to, may be exempt from CIT, provided certain requirements are met.

The taxation of non-realized gains on the transfer of shares or business assets may be postponed if the transaction is carried under the special tax neutrality regime applicable to corporate reorganisations, provided that the relevant transaction meets the requirements to apply the tax neutral regime. Neutral reorganizations include:

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- a merger (upstream, downstream or between sister companies) between the target company and the acquiring company;
- a spin-off, whereby the target company is liquidated or not, and its assets and liabilities are wholly or partially transferred to one or more acquiring companies (which may be a parent, a sister or a subsidiary company);
- a contribution in kind of a branch of activity or a universal transfer of assets of the target company to the acquiring company; and
- an exchange of shares between the target company's shareholders and the acquiring company.

A Portuguese resident company may carry forward net operating losses (NOL) to offset its taxable income of the following 5 years normally and 12 years for micro, small and medium sized companies directly operating in commercial, industrial, or agricultural activity. NOL deduction is limited to 70% of the taxable income assessed in the relevant tax year.

NOL carry-forward may be denied if, at the end of the relevant tax year, at least 50% of the relevant company's shares or voting rights were transferred, except where:

- the ownership was converted from direct to indirect (and vice versa), as well as when the ownership was converted amongst companies with the majority of its shareholding or voting rights held, directly or indirectly by the same entity;
- a tax-neutral reorganisation was carried out;
- the change of the ownership results from the death of the previous shareholder;
- the acquirer previously held, directly or indirectly, at least 20% of the share capital or the voting rights, since the beginning of the tax year in which the NOL were generated;
- the acquirer is an employee or a board member of the relevant company since, at least, the beginning of the tax year in which the NOL were generated.

In any case, if the above mentioned 50% shareholding or voting rights change occurs, NOL may still be carried forward if authorized by the Minister of Finance, insofar the transaction is proved to have economic substance (request to be submitted within 30 days after the change of ownership).

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Contrarily to share deals, in asset deals no shares are transferred, with specific assets being transferred between the negotiating parties instead.

If qualified as a transfer of an ongoing business *("trespasse")*, Stamp duty may be levied at a 5% rate on the value of the deal. In case the assets are independently transferred, Stamp duty may not be applicable, since each transfer may be subject to VAT at the applicable rates which currently range between 6% and 23%.

Through an asset deal, the acquisition of real estate is subject to IMT at a rate of 6.5% for urban property, 5% for rural land, 6.5% for urban land and 10% if the acquirer is a company resident in a black-listed country, territory or region as defined in Ministerial Order no. 150/2004 of February 13th. Stamp duty may also be due at a rate of 0,8%, on the higher of the following amounts:

- the real estate's tax value; or
- the real estate's transfer value.

However, in a share deal, if the target company is a limited liability company *("sociedade por quotas")* and general or limited partnerships with real estate assets, and if at least 75% of the shareholding is transferred, IMT at the above-mentioned rates is also applicable.

Finally, and taking into consideration that after an acquisition, the acquiring company may assume the target company's loans, and insofar an amendment of the term of a loan agreement is carried out, the tax authorities may consider that a new financing was granted, subject to Stamp duty, being the rate applicable dependant on the term of the loan. For terms of less than one year, the tax rate is 0,04% per month, or the corresponding fraction. For terms ranging from 1 to 5 years, the tax rate is 0,5%. For terms exceeding 5 years, the tax rate is 0,6%.

However certain loans, such as loans made by shareholders to the company, are exempt from Stamp duty.

B) Step-up in value

According to Portuguese Generally Accepted Accounting Principles (GAAP), which adopted the International Financial Reporting Standards (IFRS), it is possible for the acquiring company to register the business assets acquired at their fair value. Hence, a step-up (or even a stepdown) may take place in the assets' tax basis.

Every asset transferred must be identified, evaluated, and registered in the accounting records of the acquiring

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company. The acquisition value should be allocated considering the fair value of the assets and liabilities obtained, and any residual amount should be qualified as goodwill. Goodwill is not subject to depreciation for tax purposes, unless authorized by the tax authorities, and is subject to impairment tests on, at least, an annual basis.

C) Special Purpose Vehicle

As a rule, to carry out a debt pushdown upon an acquisition, a special purpose vehicle (SPV) may be incorporated in Portugal to perform the acquisition and subsequently, provided the requirements are met, apply the tax consolidation regime.

Under the tax consolidation regime, the parent company may file a group consolation CIT return, enabling NOL deduction on a consolidated basis, considering all profits and losses of all the group's companies.

In any case, provided that the special tax neutrality regime is applicable to the transaction, it may be possible to use either a Portuguese resident SPV or a company resident in another EU Member State. Additionally, there is also the possibility to opt for the tax consolidation regime (better detailed below) and have a company resident in another EU Member State as the group's ultimate parent company, provided additional requirements are met and therefore, the decision on whether to incorporate an SPV should be specifically adapted to each transaction.

Furthermore, a foreign corporate investor may also wish to consider whether the incorporation of an SPV in Portugal would be able to be used as an investment gateway to other jurisdictions, such as Brazil, Angola, Mozambique, East-Timor, or any other country with whom Portugal has a Double Tax Treaty in force. The company would then be entitled to benefit from the Portuguese participation exemption regime in its shareholdings abroad, provided all other necessary requirements are met.

Other features set forth in the Portuguese tax framework may also be considered by foreign corporate investors, such as the share capital remuneration benefit (which, provided certain requirements are met, allows cash contributions made by shareholders after the incorporation or the increase of a company's share capital to be remunerated at a rate of 7%, which is

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also considered as a deductible expense for this company).

Furthermore, we also highlight the tax regime applicable to companies authorized to operate in the Madeira Free Trade Zone which may be considered one of the most beneficial tax regimes in force within the European Union (a CIT rate of 5% on the taxable income), provided that the taxable income of the company established therein does not refer to transactions carried out with companies established in the Portuguese mainland.

D) Company mergers and share exchanges

Company mergers and share-for-share exchanges are both common operations, used either to acquire target companies or to perform group reorganisations.

The CIT Code provides for a tax-neutral regime (as adopted from the EU Tax Merger Directive for domestic law) for both operations. The special tax neutrality regime may be applied to these operations if they are executed by Portuguese resident companies (or resident in another EU Member State).

E) Tax benefits in issuing shares

The Portuguese tax law does not provide benefits to an acquiring company issuing shares as consideration (rather than cash). In such a transaction, benefits may arise for the target company or its shareholders since share consideration may enable the application of the tax neutrality reorganisation regime.

F) Transaction taxes

A share deal does not trigger Stamp duty or any other transaction tax, except for the acquisition of a shareholding of at least 75% in a limited liability company and general or limited partnerships which owns real estate (subject to IMT).

Conversely, and as previously mentioned, an asset deal qualified as a transfer of a going concern may be subject to Stamp duty at a rate of 5% on the value of the deal. If the asset deal cannot be considered as a branch of activity, Stamp duty should not be triggered, but the transfer of the assets constitutes a VATable transaction at the applicable rates (currently from 6% to 23%).

The transfer of real estate is generally subject IMT and Stamp duty on the higher of the following amounts:

- the real estate's tax value; or
- the real estate's transfer value.

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Accordingly, IMT is levied at a 5% rate for rural land, at a maximum 6,5% rate for urban immovable properties, and at a 10% rate when the acquirer is a company resident in a black-listed country, territory or region as defined in Ministerial Order no. 150/2004, of February 13. Simultaneously, Stamp duty is, generally, levied at a 0,8% rate.

Please note that the transactions may also be subject to notary fees.

As regards corporate reorganisation operations, such as mergers, the Portuguese tax framework also provides for certain benefits which assume the form of exemptions on IMT, Stamp duty and notary fees, provided certain requirements are met. In such case, the company must include in its annual tax file several documents (namely a description of the transaction and an economic study on its advantages).

G) Net Operating Losses, other tax attributes and insolvency proceedings

NOL generated in previous tax years, may be transferred to the acquiring company, provided certain conditions are met.

If the target company holds any VAT credits, said credits should not be forfeited upon a change of ownership or the transfer of business assets.

Within a merger of the target company into the acquiring company, a request may be presented to the Portuguese tax authorities to carry forward VAT credits previously held by the target company.

H) Interest relief

Interest borne by an acquiring company may be considered as deductible for tax purposes provided that said interest refers to a loan incurred deemed necessary for obtaining income subject to CIT. However, interest expenses are only deductible up to the highest of the following amounts:

- € 1 million; or
- 30% of the "tax" earnings before interest, taxes, depreciation, and amortization (EBITDA), i.e., the "accounting" EBITDA minus gains and losses arising from changes in the fair value of assets which are not considered for tax purposes, impairments and investment reversals that cannot be depreciated, income and expenses related to equity that benefitted from the participation exemption regime.

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These limits are not applicable to banking, financial and insurance entities, nor to branches of financial, credit or insurance companies whose head office is located in another EU Member State.

Beyond the aforementioned limits, financial expenses may be carried forward and deducted in the following five years (within the applicable limits in each year).

Conversely, when the amount of financial expenses does not exceed said limits, the excess amount may be deducted in the following year, under the first-in first-out (FIFO) method, within the following five years.

Portuguese transfer pricing rules are applicable to the interest rates applicable to loans granted between related parties, which should comply with the arm's length principle. Otherwise, the Portuguese tax authorities may issue an additional tax assessment.

Interest payments made by a Portuguese resident company, either to a resident or a non-resident company, are, according to the general rules, subject to withholding tax at a 25% rate.

However, said interest payments may benefit from a reduced withholding tax rate, between 5% and 15%, through the application of the DTT in force between Portugal and the jurisdiction where the beneficiary of the interest payments is established. The interest payments may also be exempt from withholding tax provided that the requirements to apply the EU Interest and Royalties Directive are met.

As an anti-abuse rule, interest income is subject to a punitive 35% withholding tax rate, if paid or made available in an account opened in name of one or more holders, on behalf of one or more unidentified third parties, and the beneficial owner is not identified, or when such beneficiary is resident in a black-listed country, territory, or region.

A group tax consolidation is available under the CIT Code. Among others, the main requirements for the application are that the parent company holds, directly or indirectly, at least 75% of the share capital and more than 50% of the voting rights of the participating companies and all companies are subject to CIT at the highest rate in force (currently 21%). As mentioned above, under the tax consolidation regime NOL deduction is available on a consolidated basis, considering all profits and losses of all the group's companies. The 70% limitation on the deduction of NOL is

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also applicable to the tax groups' taxable income.

In any case, please be advised that there is a general anti abuse clause that qualifies as invalid for tax purposes any act or transaction carried out with the sole purpose of obtaining a reduction, elimination or deferral of the tax which would otherwise be due in respect of similar acts or transactions, or even a tax advantage that would not be obtained using a similar structure. Furthermore, apart from such general anti avoidance clause, there is also a regime to avoid aggressive special tax planning, under which certain reporting obligations may apply.

I) Due diligence

Either on a stock deal or an asset deal and both from an acquiring and a target company's perspective, the acquisition process usually starts with a due diligence procedure to identify, analyse, quantify and, possibly, reduce or exclude any tax contingencies.

Based on the eventual features of the case, the acquiring company may ensure that the liabilities previously identified will be covered on contractual basis. The protection clauses are usually inserted in the asset or share purchase agreement.

As a standard market practice, the representations and warranties, gross-up clauses, specific indemnities, deed of tax covenants, escrow accounts and dispute resolution clauses usually include any tax contingencies found.

POST-ACQUISITION PLANNING

J) Restructuring

A post-acquisition restructuring may be carried out through a standard transaction, namely mergers, spin-offs, share for share exchanges and/or contributions in kind (which may benefit from the tax neutrality regime).

Please note any corporate reorganisation should always have valid economic reasons, not being made merely by tax reasons.

K) Spin-offs

Spin-offs may be executed according to the special tax neutrality regime applicable to corporate reorganisations, provided that the following requirements are met:

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- the relevant company must be resident in Portugal for tax purposes, being subject and not exempt from CIT, or resident in another EU Member State fulfilling the requirements set forth in the EU Merger Directive;
- the spin-off should have valid economic reasons, not being made merely by tax reasons;
- whenever the shareholders of the target company receive shares of the acquiring company as consideration for the transaction, they may receive some payments in cash. However, said payment cannot exceed 10% of the nominal shares received;
- the acquiring company should maintain the assets and liabilities transferred in Portugal and at the same tax value registered in the target company, i.e., book value;
- the depreciation and amortisation methods, as well as the inventory adjustments, impairment losses and provision regime previously used by the target company should be maintained for tax purposes in the new companies; and
- the acquiring company's taxable income should be assessed as if no spin-off was executed.

Certain formal requirements should also be met to apply the special tax neutrality regime to a spin-off.

A spin-off may also be executed without triggering transfer taxes (IMT, Stamp duty and notary fees), provided certain requirements are met. In such case, the company must include in its annual tax file several documents (namely a description of the transaction and an economic study on its advantages).

L) Change of residence (exit tax)

The change of residence of a Portuguese company should trigger Portuguese CIT liability. The taxable income is assessed in the year in which the company migrates out of Portugal and includes all positive and negative differences between the market value and the tax value of the company's assets (even if not yet accounted for).

Should the company opt for the migration to another EU Member State or to a country within the EEA (provided said country is subject to exchange of information obligations with Portugal like those established in the EU), the CIT assessed by the positive balance of the market value and the tax value of the company's assets may be paid as follows:

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- immediately, for the whole amount or through instalments; or
- in five annual instalments, each corresponding to 1/5 of the tax assessed, being that the payments begin on the year following the migration of residence.

If the company opts for one of the deferred payments possibilities, interest should be due as of the date in which the immediate payment should have been carried out until effective settlement. The tax authorities may request a bank guarantee corresponding to 125% of the tax due.

The above-mentioned regime is not applicable to assets and liabilities kept in Portuguese territory and allocated to a permanent establishment in Portugal of the migrating company. In this regard, it is important to note that:

- the assets and liabilities maintained should have the same tax value registered in the migrating company before the migration;
- the depreciation and amortisation methods, as well as the inventory adjustments, impairment losses and provision regime previously used by the migrated company should be maintained for tax purposes;
- the permanent establishment's taxable income should be assessed as if there was no migration; and
- the operation has valid economic reasons and its (or one of its) main objective(s) is not tax evasion.

M) Interest and dividend payments

As a rule, interest and dividend payments made by Portuguese resident companies to non-resident companies without a permanent establishment in Portugal are subject to final withholding tax at a 25% rate. With reference to dividends, the withholding should be performed either when the payment is executed or when the dividends are made available to the shareholders. In case of interest, the withholding should be performed when the interest is paid or at the interest maturity date.

Notwithstanding, the withholding tax rates applicable to interest and dividend payments may be reduced through the application of a DTT if, prior to the payment, the non-resident beneficiary of the payments provides the Portuguese company with an official form duly certified by the tax authorities of the beneficiary's residence jurisdiction. The

DTT rates for interest and dividend payments usually range between 5% and 15%.

In the specific case of interest payments and pursuant to the EU Interest and Royalties Directive, an exemption of withholding tax is applied provided that:

- the non-resident company is subject and not exempt from one of the taxes on income listed in the annex of the EU Interest and Royalties Directive annex;
- the non-resident company takes one of the corporate forms listed in the annex of the EU Interest and Royalties Directive;
- the non-resident company is considered as resident for tax purposes in another EU Member State according to the application of a DTT;
- the non-resident company qualifies as a group of associated or related companies by holding at least 25% of the share capital in the paying company, or by being held in at least 25% by the paying company, or by being both held by in at least 25% by a third company;
- the non-resident company is the beneficial owner of the income; and
- the shareholding is held for a minimum period of two years.

Such exemption may also apply to interest payments made to Swiss entities, with certain adjustments.

Interest payments made to non-resident companies which comply with these requirements, but whose share capital is mostly held, directly or indirectly, by entities resident in non-EU countries, should not be exempt from withholding tax, except where evidence is provided that the structure was not designed with the main objective of benefitting from a reduced rate.

If an interest payment does not comply with the arm's length principle, the excess amount is excluded from the exemption on withholding tax.

To benefit from the withholding tax exemption under the EU Interest and Royalties Directive, the non-resident beneficiary of the payments provides the Portuguese company with an official form duly certified by the tax authorities of the beneficiary's residence jurisdiction.

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With reference to dividend payments and pursuant to the EU Parent-Subsidiary Directive, dividend payments made by a Portuguese company to a non-resident company may be exempt from withholding tax provided that:

- the non-resident company is resident in another EU Member State or an EEA country (provided said country is subject to exchange of information obligations with Portugal like those established in the EU) or in a country that has a DTT in force with Portugal which includes exchange of information procedures;
- the non-resident company holds at least 10% of the Portuguese company for an uninterrupted period of 12 months;
- the non-resident company is subject and not exempt from one of the taxes on income mentioned in the EU Parent-Subsidiary Directive or, in case of companies that are residents in an EEA country or a country with a DTT in force with Portugal, a similar income tax not lower than 60% of the Portuguese CIT rate in force (i.e., 12,6% for 2019);
- the non-resident company takes one of the corporate forms listed in the annex of the EU Interest and Royalties Directive; and
- the non-resident company provides evidence prior to the dividend payments that it qualifies for the application of the EU Parent-Subsidiary Directive through a declaration issued and authenticated by its jurisdiction's tax authorities.

Such withholding tax exemption may apply to interest payments made to Swiss entities, with adjustments.

Once again, we highlight the participation exemption regime applicable to dividends paid by non-resident companies to Portuguese resident companies, mentioned above.

Interest and dividend payments are subject to a final withholding tax of 35% whenever paid or made available in an account opened in name of one or more holders, on behalf of one or more unidentified third parties, and the beneficial owner is not identified, or when the beneficiary is resident in a black-listed country, territory, or region.

N) Tax-efficient extraction of profits

In addition to the interest and dividend tax framework detailed above, royalties may also be an alternative to extract

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profits, being able to benefit from the EU Interest and Royalties Directive and from reduced rates available in the DTTs in force between Portugal and the relevant jurisdiction.

An acquiring company may also consider, subject to analysis on a case-by-case basis, the reimbursement of supplementary capital contributions, which may be exempt from taxation.

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

O) Disposals

From a seller's perspective, investment in a Portuguese target company may be carried out through the (i) disposal of its business assets, (ii) disposal of shares in the target company or (iii) disposal of shares held in a foreign holding company.

A case-by-case analysis is advisable, depending largely on the intentions of both the buyer and the seller, as well as on the tax attributes of the assets or shares to be transferred.

P) Share disposals

The Portuguese Tax Benefit Code (EBF) establishes that capital gains obtained by a non-resident company, without a permanent establishment in Portugal to which the gains may be allocated to, arising from the sale of shares in a Portuguese company, are CIT exempt, except if:

- more than 25% of the share capital of the non-resident entity is held, directly or indirectly, by Portuguese resident entities except if the non-resident entity is an EU-resident (or any State that has a DTT with Portugal), does not benefit from CIT (or CIT-equivalent) exemptions, is subject to, at least 12,6% tax rate in the resident State, has 10% of the share capital during one year before alienation and does not take part at any tax-avoidance scheme;
- the non-resident company is not resident or domiciled in a black-listed country, territory; or
- the capital gains arise from to the sale of stock in a Portuguese company whose assets correspond in more than 50% to real estate located in Portugal or from the sale of stock in a Portuguese holding company (SGPS) which controls a Portuguese company whose assets represented in more than 50% to real estate located in Portugal.

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Additionally, please note that most of Portugal's DTTs provide for residence taxation on capital gains arising from the disposal of shares, except in companies whose assets are mainly constituted by real estate in Portugal.

Q) Tax deferral

Gains arising from the disposal of shares in a Portuguese company may be exempt from taxation provided that the participation exemption regime or the special tax neutrality regime requirements are met. Gains realized by a non-resident company, from the disposal of shares in a Portuguese company, may also be exempt, provided that no exception to the rule set forth in the Portuguese Tax Benefit Code applies.

A deferral of tax on gains arising from the disposal of business assets may also be achieved provided that the reinvestment regime is applicable following the relevant transaction (allowing for the deferral of at least 50% of the gains), or provided that the special tax neutrality regime is applicable to a corporate reorganisation.

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