Chapter XX

PORTUGAL

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I OVERVIEW

The Portuguese transfer pricing regime is currently laid down in Article 63[2] of the Corporate Income Tax (CIT) Code and regulated by Ministerial Order No. 1446-C/2001, 21 December 2001 (Order 1446-C/2001)[3], without prejudice to other legal provisions regulating specific matters.

This regime is based on the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines (the OECD Guidelines), reflecting the arm's-length principle. In addition, the preamble of Order 1446-C/2001 mentions that the OECD Guidelines should be followed in cases of greater technical complexity or in the absence of internal rules. Thus, the OECD Guidelines (as updated from time to time), as well as other OECD guidelines (namely, the Transfer Pricing Guidance on Financial Transactions and the OECD Guidance on Transfer Pricing Implications of the COVID-19 Pandemic, both recently released) should be used as an interpretative tool and a source of guidance by taxpayers, tax authorities and courts.

The CIT Code establishes that all transactions between a taxpayer and another entity, with which it has special relations (i.e., controlled transactions), must be carried out as if both were independent entities conducting comparable transactions.

The CIT Code defines transactions for the purposes of application of the transfer pricing rules as:

a any commercial transactions, including transactions or series of transactions related to tangible or intangible assets, rights or services, even where concluded under an agreement, namely a cost-sharing arrangement or an intra-group services agreement;

b financial transactions; and

c restructuring and reorganisation transactions involving changing the current business, ending or renegotiating the existing contracts, particularly when involving the transfer of tangible and intangible assets, of rights over intangibles, or compensation for damages or loss of earnings.

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2 Article 63 of the CIT Code was recently amended by Law No. 119/2019, 18 September 2019.

3 It is expected that Order 1446-C/2001 will be amended soon to reflect the amendments introduced in Article 63 of the CIT Code by Law No. 119/2019, 18 September 2019 and, possibly, other OECD recommendations.

Under the CIT Code, two entities are deemed related for transfer pricing purposes if one entity has, directly or indirectly, a significant influence over the management of the other entity; such a significant influence is deemed to exist in the following cases:

- *a* where the entities concerned are a shareholder holding, directly or indirectly, at least 20 per cent of the share capital or voting rights of an entity (or their respective spouses, ascendants or descendants) and that entity;
- *b* where the same shareholders, their spouses, ascendants or descendants hold, directly or indirectly, at least 20 per cent of the share capital or voting rights of the two entities concerned;
- *c* where the entities concerned are the members of the corporate bodies (or the management, governing or supervisory bodies) of an entity and that entity;
- *d* where the majority of the corporate bodies or the management, governing or supervisory bodies of the entities concerned are the same or are their spouses, ascendants or descendants;
- *e* where the entities concerned are linked by a subordination agreement, joint group agreement or other agreement of equivalent effect;
- *f* where the entities concerned are in a control relationship as defined in the Commercial Companies Code;
- *g* where the entities concerned have a legal relationship, whose terms and conditions allow one entity to influence the management decisions of the other, due to facts or circumstances beyond or outside the commercial or professional relationship; and
- *h* where the entities concerned are a Portuguese resident entity or a Portuguese permanent establishment (PE) of a non-resident entity and an entity resident in a country, territory or region with a clearly more favourable tax regime, included in the list approved by the corresponding ministerial order of the Ministry of Finance.[4]

If a taxpayer fails to comply with the transfer pricing rules, the Portuguese tax authorities may make positive adjustments to the taxpayer's taxable profit (primary adjustment) and consequently issue additional assessments, plus interest and penalties.

The transfer pricing legislation applies not only to transactions between Portuguese taxpayers, but also to transactions between Portuguese entities and related non-resident entities, including transactions between PEs and their head offices or between PEs of the same head office, provided that one of them is resident or established in Portugal.

In the case of controlled transactions carried out with non-resident entities not compliant with the arm's-length principle, the Portuguese taxpayer should indicate in its tax return the positive adjustment corresponding to the tax effects resulting from this deviation. If the positive adjustment is not made voluntarily by the taxpayer or is deemed insufficient, the Portuguese tax authorities may also proceed with a primary adjustment to the taxable profit of the resident entity, and consequently issue additional assessments, plus interest and penalties.

An adjustment made to the taxable profit of a taxpayer in a controlled transaction should, in principle, be reflected by an offsetting adjustment to the taxable profit for CIT purposes or the taxable income for personal income tax (PIT) purposes of the related entity (correlative adjustment). Where a primary adjustment is made to the taxable profit of a

4 Ministerial Order No. 150/2004, 15 February 2004 (as amended from time to time).

foreign related entity, the Portuguese tax authorities may make a correlative adjustment to the taxable profit of the resident entity in the terms allowed by applicable international instruments, if any (see Section IX.ii).

The Portuguese transfer pricing rules are mainly addressed to corporate entities (i.e., CIT taxpayers) and, in certain specific circumstances foreseen in the law, to individuals (PIT taxpayers). In any case, correlative adjustments to other individuals or entities with which the taxpayers have entered into transactions may be allowed.

Although the CIT Code mentions adjustments to taxable income for PIT purposes and Order 1446-C/2001 (implementing Article 63 of the CIT Code) states that transfer pricing rules should apply to any transactions involving taxpayers of CIT or PIT and any other entities, until 2021, the PIT Code did not have any rules on transfer pricing and therefore, it has been considered that, as a general rule, transfer pricing rules should not apply to PIT taxpayers directly (i.e., by means of primary adjustments).

However, the Budget State Law for 2021, introduced a new rule on the PIT Code that establishes that transactions between a PIT taxpayer and an entity, with which he or she has special relations (as defined in Article 63 of the CIT Code), must be carried out as if both were independent entities conducting comparable transactions, being the regime foreseen in Article 63 of the CIT Code that applies with the necessary adjustments.

In addition, when it comes to PIT taxpayers who obtain a business or professional income (Category B) and are subject to taxation on their profits (i.e., outside a simplified regime based on coefficients), as there is a generic reference to CIT rules for determining their taxable income, it may be argued that transfer pricing rules, including primary adjustments (as established in the CIT Code), should apply.

Further to the transfer pricing rules, Portuguese law also provides for a general anti-avoidance rule and specific anti-avoidance provisions (such as a controlled foreign companies rule), which may apply in similar contexts but with different approaches.

As a general rule, if a transaction is not compliant with the arm's-length principle, there are no specific corporate law or accounting implications. Transfer pricing adjustments work as deviations from the accounting records (the prices charged and recorded for accounting purposes are replaced by the market value only for tax purposes), having an impact only at the level of the CIT return or CIT assessment, and not in the accounting records.

II FILING REQUIREMENTS

Under Portuguese law, there are three main filing and documentation obligations related to transfer pricing, as follows.

i Annual accounting and tax return

Each taxpayer must declare in its annual accounting and tax return (IES) any transactions carried out with related entities during the relevant tax period, including the following information:

a identification of the parties involved in the transactions;

b identification of the amount and nature of the transactions performed with each related party;

c identification of the transfer pricing methods adopted and any changes of methods;

d identification of the amount of transfer pricing adjustments made due to lack of compliance with the arm's-length principle; and *e* a statement confirming that transfer pricing documentation has been prepared on a timely basis and is available.

The IES should be filed by the 15th day of the seventh month following the end of each tax year (as a general rule, until the 15 July). In this regard, in the context of the covid-19 pandemic, the Portuguese Government have been postponing several deadlines and, in particular, the deadline to file the IES of 2019 (as a general rule, 15 July 2020) was postponed to 15 September 2020. Should the pandemic situation remain unchanged, a similar postponement may be expected for 2021.

ii Transfer pricing tax file

Taxpayers with a turnover of €3 million or more in the previous year should maintain in a prepared condition their documentation regarding the transfer pricing policy adopted (i.e., the transfer pricing tax file).

The list of information required for the transfer pricing tax file is detailed in Article 14 of Order 1446-C/2001 and includes the following: (1) description and characterisation of the special relations; (2) characterisation of the activities performed by the taxpayer and the related entities; (3) identification of the goods, rights and services under the controlled transactions; (4) description of the functions performed, assets used and risks assumed by the taxpayer and the related parties; (5) technical studies; (6) instructions or directives related to the transfer pricing policy; (7) the agreements entered into with related parties corresponding amendments and third parties; (8) explanation about the application of methods adopted and reasoning underlying the method selection; (9) information regarding comparable data, including functional and financial analysis; and (10) other information supporting the terms and conditions agreed and the adjustments made. Specific information and documentation are required for purposes of cost-sharing agreements and intra-group service agreements.

With the transfer pricing tax file, the taxpayer should be in a position to prove (1) the market parity of the terms and conditions agreed with related parties, and (2) that the selection and application of the methods was the most appropriate.

As a general rule, the transfer pricing tax file is not required to be automatically transferred to the Portuguese tax authorities; the taxpayer should keep the transfer pricing tax file and be able to provide it to the Portuguese tax authorities (at their request) for a period of 10 years.

However, CIT taxpayers deemed to be large taxpayers by Order No. 130/2016 of 10 May 2016[5] and, therefore, included in the Large Taxpayers Unit (LTU), as well as entities subject to taxation under the tax consolidation regime, are required to submit the transfer pricing tax file. The Portuguese tax authorities have already issued and published in their website a set of clarifications regarding compliance with this obligation.

5 The list of large taxpayers includes the following: (1) taxpayers subject to supervision by the Bank of Portugal or the Insurance Authority or collective investment undertakings subject to supervision of the Portuguese Securities Market Commission; (2) taxpayers with a turnover higher than €200 million; (3) taxpayers qualified as holding companies with an income higher than €200 million; (4) taxpayers with a total amount of taxes paid higher than €20 million; (5) taxpayers that are considered significant, even if the above-mentioned criteria are not met (namely, because of their relationships with entities that comply with one of the above-mentioned criteria); and (6) taxpayers included in a tax group, to the extent that one of the group's companies complies with the above-mentioned criteria.

The deadline applicable for the submission of the transfer pricing tax file (when required) is the same as the one applicable to the annual accounting and tax return (IES) – namely, by the end of the 15th day of the seventh month following the end of each tax year (as a general rule, until the 15 of July). In the context of the covid-19 pandemic, and in line with the postponement of the deadline to submit the IES, the Portuguese Government also postponed the deadline to submit the transfer pricing tax file regarding the tax year of 2019 (as a general rule, 15 July 2020) to 15 September 2020. Should the pandemic situation remain unchanged, then a similar postponement may be expected for 2021.

Portuguese law has not (yet) introduced the documentation format recommended by Action 13 of the OECD Base Erosion and Profit Shifting (BEPS) Action Plan and, therefore, rules regarding master and local files are not applicable in Portugal. This notwithstanding, the transfer pricing tax file required by the Portuguese law addresses the most relevant items of both master and local files and the Portuguese tax authorities have already confirmed that they accept transfer pricing files prepared in accordance with master and local file formats, provided that they contain all elements required by the law (in particular by Order 1446-C/2001).

iii Country-by-country reporting

In 2016, Article 121-A was introduced into the CIT Code, establishing country-by-country reporting for multinational groups, as recommended by the OECD in BEPS Action 13.

The Portuguese reporting rules follow the general terms recommended in BEPS Action 13, including on the information to be reported.

According to Article 121-A of the CIT Code, a Portuguese resident entity is required to file a country-by-country report (CbCR) with financial and tax information by country or fiscal jurisdiction, whenever the Portuguese resident entity:

a is required to prepare consolidated financial statements;

b has consolidated income equal to or higher than €750 million; and

c holds or controls one or more entities or PEs in other countries or jurisdictions, and is not held by another entity or entities in a country or jurisdiction where such entities would be similarly obliged to submit a CbCR, which would be exchanged with Portugal (i.e., when the Portuguese resident company is deemed to be a parent company).

A Portuguese resident entity that is not the parent company of the multinational group may also be required to file a CbCR, if one of the following conditions is met:

a the entity was designated as the reporting company of the group by the parent company;

b the entity is held or controlled by non-resident entities not required to submit a CbCR; or

c the entity is held or controlled by entities resident in countries or jurisdictions with which Portugal does not have a relevant exchange-of-information agreement in force, or those entities systematically infringe a relevant exchange-of-information agreement such that the Portuguese tax authorities have to notify any of the multinational group's entities.

The CbCR should be electronically filed by the end of the 12th month following the end of each tax year to which the report refers. However, any Portuguese tax resident or Portuguese PE included in a multinational group that qualifies for country-by-country reporting should communicate to the Portuguese tax authorities the identification and jurisdiction of the reporting entity by the end of the fifth month following the end of each tax year to which the report refers.

iv. Mandatory Disclosure Rules

Finally, it should be noted that Portugal has already implemented the mandatory disclosure rules (MDR) for intermediaries and taxpayers, as recommended by BEPS Action 12 and imposed by Council Directive 2018/822/EU of 25 May 2018 (amending Directive 2011/16/EU) – commonly referred as DAC6 – transposed into the Portuguese framework by Law No. 26/2020 of 21 July.

The MDR introduced an obligation on intermediaries and taxpayers (as applicable) to disclose (under a reporting mechanism) to the relevant tax authorities within the European Union (EU) information on certain arrangements that have tax relevance and indicate a potential risk of tax evasion. The tax authorities receiving the reporting should then exchange information with the tax authorities of the EU member states involved in the arrangement.

An arrangement should be reported to the tax authorities if it fulfils certain key features (hallmarks) as specifically foreseen in the law. In addition to hallmark-related arrangements involving deductible cross-border payments made between two or more associated enterprises, the MDR specifically foresee a category of hallmarks related to arrangements involving transfer pricing matters (Category E – Specific Hallmarks concerning transfer pricing), in relation to which the following arrangements should be disclosed:

- *a* an arrangement that involves the use of unilateral safe harbour rules;
- *b* an arrangement involving the transfer of hard-to-value intangibles; and
- *c* an arrangement involving an intragroup cross-border transfer of functions, risks or assets (or all three), if the projected annual earnings before interest and taxes (EBIT), during the three-year period after the transfer of the transferor or transferors are less than 50 per cent of the projected annual EBIT of such transferor or transferors if the transfer had not been made.

As a general rule, and without prejudice of transitional rules and specific rules applicable to intermediaries subject to legal or contractual professional privilege, the relevant arrangements should be reported in the 30 days following:

- *a* the day after the arrangement is made available for implementation;
- *b* the day after the arrangement is ready for implementation; or
- *c* the date on which the first step in the implementation of the arrangements was taken, whichever occurs first.

In Portugal, the reporting obligations should be complied with through the submission of a specific form – *Modelo 58* – as approved by the Portuguese government.

The MDR, as transposed into the Portuguese legislation, apply to cross-border arrangements whose first step took place after 25 June 2018 and also purely domestic arrangements whose first step took place after 1 July 2020.

III PRESENTING THE CASE

i Pricing methods

The transfer pricing methods, as well as the comparable factors adopted by the Portuguese legislation, are closely based on the OECD Guidelines.

Indeed, according to the CIT Code, the methods to be adopted to decide the terms and conditions that would normally be agreed, accepted and applied between independent entities, should be as follows:

a the comparable uncontrolled price method, the resale price method, the cost-plus method, the profit split method or the transactional net margin method; or

b other methods, techniques or models of economic assets' evaluation – in the event that the methods referred to at (a) above cannot be applied due to the unique characteristics of the relevant transactions or the lack of information or reliable comparable data related to similar transactions between independent parties, especially when the transactions refer to real estate, unlisted shareholdings, credit rights or intangible assets.

Portuguese law has adopted the best-method rule, meaning that the taxpayer should adopt the most adequate method. The most adequate method is defined in Order 1446-C/2001 as the method that is most likely to ensure the highest degree of comparability between a controlled transaction and transactions between independent entities (uncontrolled transactions).

The transfer pricing tax file must include an explanation of the method or methods used to determine an arm's-length price for each transaction and the rationale for the selection.

Order 1446-C/2001 details each method and provides examples of situations where each method may be deemed appropriate.

Where comparable factors are concerned, Order 1446-C/2001 provides some indications regarding the selection of potential comparable uncontrolled transactions.

For instance, and as a general rule, internal comparable transactions (i.e., transactions between a party to the controlled transaction and an independent party) are preferable to external comparable transactions (i.e., transactions between two independent parties).

In addition, Order 1446-C/2001 establishes that when the terms and conditions of the comparable transactions are not fully comparable in any of the relevant aspects, comparability adjustments must be performed to eliminate the effect of the existing differences.

The transfer pricing tax file must include information about the comparable data used, including research records, and sensitivity and statistical analyses.

Finally, it should be noted that special rules are provided for cost-sharing agreements and intra-group services agreements, which follow the principles of the OECD Guidelines, as updated by BEPS Actions 8–10.

ii Authority scrutiny and evidence gathering

As a general rule, taxpayers' transfer pricing policy may be analysed and challenged by the Portuguese tax authorities during tax audits (i.e., procedures for the control and investigation of tax matters, verification of taxpayers' fulfilment of their tax obligations and prevention and detection of tax infringements) at the level of the taxpayer, related parties or even third parties.

During a tax audit, the Portuguese tax authorities are allowed to ask a taxpayer, a related party or even a third party for any type of information related to the taxpayer's activity. The

Portuguese tax authorities may also ask to exchange information with tax authorities of other jurisdictions, using the available international instruments for the exchange of information (e.g., EU instruments, double-tax treaties (DTTs) and exchange-of-information agreements).

Under a general principle of collaboration, during tax audits, taxpayers may offer further information, documentation or even expert analysis to the Portuguese tax authorities.

Any taxpayer may be audited by the tax authorities. However, as a general rule, the chances of a taxpayer being audited vary depending on the type and amount of income obtained, the type of transactions entered into (for transfer pricing purposes, the relevance and nature of controlled transactions) and the type and amount of tax deductions claimed in the taxpayer's tax return.

Notwithstanding, it should be noted that large taxpayers (as defined by Order No. 130/2016 of 10 May 2016) – generally found in multinational groups – are subject to permanent monitoring, auditing and supervision by the Portuguese tax authorities through the LTU. According to the applicable law, one of the statutory duties of the LTU, together with the tax auditors and the large taxpayers, is to promote the due application of the transfer pricing rules.

It should be taken into account that the MDR (DAC6) and the CbCR, in addition to the IES (and the transfer pricing tax file, in particular, in the case of large taxpayers and entities subject to taxation under the tax consolidation regime, which should submit it annually), provide the Portuguese tax authorities with much more information on controlled transactions, allowing them to identify more easily any possible infringements of transfer pricing rules.

Finally, transfer pricing matters have increasingly become one of the key concerns of the Portuguese tax authorities when looking at taxpayers' tax situation.

IV INTANGIBLE ASSETS

Portuguese transfer pricing legislation does not establish any specific rules for intangible property. However, in accordance with the general reference to the OECD Guidelines established in Portuguese law, the general rules on transfer pricing should be interpreted and complemented by Chapter VI of the OECD Guidelines, as updated by the BEPS Actions 8–10.

Because of the express reference in law to the OECD Guidelines, substance principles (mostly regarding the ownership of intangible assets in relation to their development, enhancement, maintenance, protection and exploitation (DEMPE)) should be deemed to have been assimilated by the Portuguese framework on the transfer pricing of intangibles.

Indeed, in this regard, the OECD recommends the application of a substance principle to the creation of intangible value (value creation), to ensure that income or losses from intangibles are attributed to the entities that carry out or control the DEMPE functions, irrespective of the legal owner of the intangible asset.

On the basis of the DEMPE principles, the intangible outcomes should be aligned with the value creation of intangible assets (the functions performed, the assets used and the risks assumed), avoiding profit shifting achieved through artificial structures.

Note that substance principles regarding intangible property had previously been introduced into Portuguese law but this was done through an amendment to the Portuguese patent box regime. The amendment was made in line with the modified nexus approach developed as part of the BEPS Action 5, which requires that the benefits received be aligned with the actual activities performed by the taxpayer claiming the benefits.

On the basis of the above, it is expected that the Portuguese tax authorities will increase their scrutiny for substance under transfer pricing analyses related to intangible property.

However, it is not yet clear how, in practice, the application of these principles will materialise in transfer pricing adjustments in Portugal. In this regard, it should be noted that, although Portuguese tax authorities have already tried to apply substance principles and requalify transactions under the transfer pricing rules, it has been argued by taxpayers that the requalification of transactions can only be made under the general anti-avoidance rule and only where the conditions of the anti-avoidance rule apply.

V SETTLEMENTS

Portuguese legislation, in Article 138 of the CIT Code and Ministerial Order No. 620-A/2008 of 16 July 2008, provides for a system of advance pricing agreements (APAs), in line with the OECD Guidelines.

APAs are intended to provide legal certainty to taxpayers through prior consensus with the tax authorities regarding the transfer pricing methods used to determine arm's-length conditions of controlled transactions covered by the APA (as the tax authorities agree not to seek transfer pricing adjustments for such transactions while the APA is in force).

An APA may be classified as (1) unilateral, if entered into by the Portuguese tax authorities and Portuguese taxpayers; or (2) bilateral or multilateral, if entered into by taxpayers, the Portuguese tax authorities and one or more foreign tax authorities.

Bilateral and multilateral APAs can only be entered into with states with which Portugal has entered into a DTT, as the corresponding procedure comprises a phase of consultations between the tax authorities of the jurisdictions involved, in accordance with the mutual agreement procedure (MAP) established in the applicable DTT (based on Article 25, No. 3 of the OECD Model Convention).

The procedure should be initiated by the taxpayer and involves:

a a preliminary phase, for an initial evaluation of the terms and conditions of the agreement and its effects, which should be concluded within 60 days; and

b a submission phase, for the analysis and negotiation of the APA proposal, which should take no longer than 180 days in the case of unilateral agreements, and 360 days in the case of bilateral and multilateral agreements.

During the procedure, taxpayers should provide the tax authorities with detailed information or documentation regarding their transfer pricing policy, and they cannot refuse to share any information or documentation required by law or requested by the Portuguese tax authorities.

APAs should be settled for a period no longer than four taxable years, but they can be renewed at a taxpayer's request, if the legal conditions are met.

VI INVESTIGATIONS

As previously mentioned, taxpayers' transfer pricing policies may be investigated and challenged by the Portuguese tax authorities during tax audits.

Tax audits are classified as (1) internal, if they are conducted in the Portuguese tax authorities' facilities and based on documentation held or obtained by them, or (2) external, if they are conducted at the facilities of the taxpayer or relevant third parties or any other place to which the Portuguese tax authorities do not have access.

Depending on its classification, the tax audit may follow a specific procedure; however, in both cases:

a it should be initiated prior to the end of the statute of limitations period for tax assessment, which, as a general rule, is four years;

b it should be based on a general principle of collaboration (both ways);

c after the end of the acts of inspection, a preliminary report should be notified to the relevant taxpayer, which will have the right to a prior hearing; and

d the tax audit should be concluded (with the issuance and notification of a final audit report)[6] within six months, which can be extended for two more three-month periods if certain legal conditions are met.

The statute of limitations period for tax assessment (which, as noted above, is generally four years) is suspended if an external tax audit is initiated; however, this suspension does not apply if the tax audit is not concluded within six months.

As a general rule, the result of a tax audit (i.e., the final audit report) cannot itself be challenged. If, as a result of the tax audit, the Portuguese tax authorities issue an additional assessment, the tax assessment can be challenged by the taxpayer through an administrative claim or, directly, through a judicial claim filed with the judicial court or the arbitration court (see Section VII.i).

If the taxpayer decides to challenge a tax assessment by way of an administrative claim, a petition should be submitted within 120 days of the deadline for payment of the tax assessment.

If the administrative claim is partially or totally overruled, the taxpayer may (1) appeal to the Ministry of Finance, within 30 days of the date of notification of the administrative claim decision, or (2) submit a judicial claim directly with the judicial court or the arbitration court (see Section VII.i.).

VII LITIGATION

i Procedure

Taxpayers may choose to challenge tax assessments before the court (1) directly (i.e., immediately after the issuance of the tax assessment), or (2) after the overruling of an administrative claim or appeal.

In this regard, the following solutions are available:

a Judicial courts: the claim must be submitted within three months of the deadline for payment of the tax assessment or, if an administrative claim or appeal is rejected, within three months of the date the taxpayer was notified of it.

6 As for transfer pricing corrections performed by the Portuguese tax authorities, Article 77 of the Portuguese General Tax Law establishes justification standards higher than the regular ones.

b Arbitration courts (operating within the framework of the Centre for Administrative Arbitration): the claim must be submitted within 90 days of the events referred to at (a) above for judicial courts.

In both solutions (judicial and arbitration), taxpayers may provide to the relevant court any kind of evidence by any lawful means (including expert analysis and testimonial evidence, which are quite common in transfer pricing litigation).

The arbitration solution is only available if the value of the dispute is not higher than €10 million. Arbitration courts must rule in accordance with the law and are barred from ruling *ex aequo et bono* (i.e., they cannot decide on the basis of fairness).

Generally, arbitration provides for a fast and high-quality decision-making process. In fact, from the date the arbitration challenge is presented, the arbitration court should not take more than 12 months to issue a decision, while judicial courts may take several years to issue a decision.

However, in the event of a final unfavourable decision from an arbitration court it is rarely possible to appeal (because of the limited legal framework for appeals against the arbitration decisions rendered).

Nevertheless, judicial court decisions may be appealed to a higher court – to the second instance (the Central Administrative Court) if there are factual and legal grounds for an appeal, or directly to the third instance (the Administrative Supreme Court) if the appeal is based solely on legal grounds – within 30 days of the date of notification to the taxpayer.

ii Recent cases

The most recent case law on transfer pricing focuses mainly on financing transactions and intra-group services (cost allocation). There have also been several disputes related to the sale and purchase of goods and shares and IP transactions (payments of royalties).

The main subjects of disagreement on transfer pricing (giving rise to litigation) between the Portuguese tax authorities and taxpayers have been:

a the level of comparability between controlled and uncontrolled transactions;
b the choice of transfer pricing methods;
c the verification of the legal conditions for the application of the transfer pricing regime; and
d the burden of proof.

It is noteworthy that, under transfer pricing disputes, Portuguese (judicial and arbitration) courts have been particularly focused on burden of proof matters, taking into consideration that (1) the burden of proof of lack of compliance with the arm's-length principle lies with the Portuguese tax authorities, and (2) the Portuguese tax authorities are subject to a special obligation of justification (the special duty to state reasons) in case of transfer pricing corrections, as established in Article 77 of the Portuguese General Tax Law.

VIII SECONDARY ADJUSTMENT AND PENALTIES

i Secondary adjustments

In Portugal, there are no specific provisions for secondary adjustments and, therefore, in accordance with the principles of legality in tax matters, such adjustments are not allowed.

Furthermore, in practice, taxpayers and the Portuguese tax authorities do not perform these kinds of adjustments.

ii Penalties

Transfer pricing adjustments made by the Portuguese tax authorities may translate into additional income tax assessments, with corresponding interest and penalties, as follows:

a compensatory interest at an annual rate of 4 per cent on the additional income tax due; and

b a general penalty for an incomplete or inaccurate tax return of between €750 and €45,000.

The following penalties may also apply for inaccurate compliance or failure to comply with transfer pricing ancillary obligations:

a failure to (1) submit the transfer pricing file (when due or requested), (2) identify the reporting entity for CbCR purposes, or (3) submit the CbCR, is punished with a penalty of between €500 and €10,000, plus an additional 5 per cent per day of delay; and

b an incomplete or inaccurate (1) transfer pricing file, (2) identification of the reporting entity for CbCR purposes, or (3) CbCR, is punished with a penalty of between €750 and €45,000.

Specific penalties apply in the case of failure to submit, or incomplete or inaccurate submission of the IES, as well as in the case of lack of compliance or inaccurate compliance with the obligations arising from the MDR.

Taxpayers are allowed to challenge penalties before the Portuguese tax authorities or the judicial courts.

IX BROADER TAXATION ISSUES

i Diverted profits tax, digital sales tax and other supplementary measures

In Portugal, there is no diverted profits tax, digital sales tax or other tax measures supplementing transfer pricing rules. In contrast to other EU jurisdictions (about half of the EU member states have already implemented, proposed or are about to implement digital sales tax), in Portugal a digital sales tax has not even been proposed. However, the European Commission has recently launched an initiative aimed at introducing a digital levy in the EU to address the issue of fair taxation of the digital economy. This initiative is to be proposed until June 2021 and implemented at the beginning of 2023. Thus, changes in this regard may be expected in the coming years.

ii Tax challenges arising from digitalisation

Portugal has not yet adopted any relevant measures to address the tax challenges of digitalisation. However, some developments in this regard are expected, at least when a consensus is reached by the OECD/G20 Inclusive Framework on BEPS or when new EU measures are defined (or both).

Nevertheless, under the Programme of Work for Addressing the Tax Challenges of the Digitalisation of the Economy, the OECD/G20 Inclusive Framework on BEPS is currently working on the relevant proposals, grouped into the following two pillars:

a the unified approach on new profit allocation and nexus rules (pillar one); and

b the Global Anti-Base Erosion (GloBE) proposals for the adoption of a minimum corporate income tax for taxing multinationals (pillar two).

The Inclusive Framework goal is to reach a political consensus on pillar one and two by mid-2021.

Conversely, within the context of the EU, as mentioned in point i. above, the European Commission launched an initiative aimed at introducing an EU digital levy (to enter into force in 2023). The European Commission has stated that 'the initiative should designed in a way to be compatible with the international agreement to be reached in the OECD as well as border international obligations.'

iii Transfer pricing implications of covid-19

The covid-19 outbreak introduced new challenges at the level of transfer pricing policies adopted by taxpayers (in particular by multinational groups), namely in terms of liquidity, supply chains, control functions and business strategy.

As a result of the new economic scenario created by the pandemic, companies may need to review their transfer pricing policies and arrangements, and prepare themselves for an expected increase in scrutiny by the tax authorities in the coming years (in particular, through the preparation of detailed and consistent supporting documentation justifying any review of transfer pricing policies).

Although, no specific rules have been introduced in the Portuguese legislation or any guidance has been issued by the Portuguese tax authorities, the general rules on transfer pricing should be interpreted in accordance with the OECD. In this regard, particular relevance should be given to the OECD Guidance on Transfer Pricing Implications, introduced as a result of the covid-19 pandemic, a guidance that has been approved by the 137 members of the OECD/G20 Inclusive Framework on BEPS (of which Portugal is a part) and published on 18 December 2020, clarifying and illustrating 'the practical application of the arm's-length principle' in this specific context.

iv Double taxation

Portugal has an extensive network of DTTs, which, as a general rule, follow the OECD Model Convention, allowing for (1) correlative adjustments in the state of residence of a related entity when a primary adjustment is made in the state of residence of the other related entity, to avoid potential double taxation (in line with Article 9 of the OECD Model Convention); and (2) the application of the mutual agreement procedure (MAP) (in line with Article 25 of the OECD Model Convention).

When a DTT provides a MAP clause, one of the related entities may ask the corresponding tax authorities to initiate the corresponding MAP to reach an agreement with the other relevant tax authorities. However, if this fails and no agreement is concluded, the double taxation remains.

Alternatively, when the related entities are both resident in EU Member States, the taxpayers may apply for the procedure provided in the EU Arbitration Convention[7] to settle a situation of double taxation arising from a transfer pricing adjustment. Under this procedure:

a the competent tax authorities should first try to reach an agreement on the transfer pricing adjustments; or

b if they fail to reach agreement within two years, they must set up an advisory commission that will decide.

Therefore, as the mechanism provided in the EU Arbitration Convention is more effective than a MAP, it is recommended that, when possible, taxpayers apply for the EU Arbitration Convention procedure.

However, it should be noted that Portugal signed, ratified, approved and deposited the multilateral instrument (MLI) introduced by BEPS Action 15 and chose to introduce mandatory binding arbitration (as defined in Part IV of the MLI). Therefore, DTTs entered into with signatory countries of the MLI that have chosen to introduce arbitration provisions will provide that disputes unresolved under a MAP should be submitted to an arbitral panel, whose decision is binding. The MLI entered into force in Portugal on 1 June 2020.

v Consequential impact for other taxes

Transfer pricing adjustments are preferably a matter of income tax (CIT or even PIT) and, as a general rule, they do not trigger any impact on other taxes.

This notwithstanding, transfer pricing adjustments may have customs or value added tax (VAT) implications, which should be carefully analysed on a case-by-case basis.

Where customs duties are concerned, it is established in Articles 70 et seq. of the Union Customs Code that, when transactions are carried out between related parties (as defined for customs purposes) and the relationship influences the price, the value of goods for customs purposes should not be based on the transaction price but determined in accordance with certain legal criteria based on transactions with identical or similar goods.

Considering that valuation regimes for customs duties and transfer pricing are different, it is possible for different values to be attributed to the same transaction for customs and transfer pricing purposes. Thus, it may be argued that in the event of a transfer pricing adjustment in the import country (having been considered, for transfer pricing purposes, an amount lower than the customs value), the taxpayer can ask for a refund of the customs duties paid in excess, under Article 116 of the Union Customs Code. The application for the refund should in any case be submitted within three years of the date of notification of the customs debt.

As for VAT, the corresponding correction as a result of transfer pricing adjustments would depend on the issue of a corrective invoice.

However, considering VAT neutrality (because of the right to deduct input VAT), as a general rule, there is no need for price adjustments for VAT purposes as a result of transfer pricing adjustments.

7 Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC Official Journal L 225 of 20 August 1990).

This notwithstanding, the VAT Code provides for a VAT-specific transfer pricing rule[8] applicable when a transaction is carried out between related entities (as defined in the CIT Code, but including relationships between employers and employees, their family or other closely connected people) when one of the entities does not have a full right to a VAT deduction.

The VAT transfer pricing rule applies automatically whenever one of the following situations verifies:

a the consideration is lower than the open market value and the recipient of the supply does not have a full right to a VAT deduction;

b the consideration is lower than the open market value and the supplier does not have a full right to a VAT deduction and the supply is subject to an internal exemption; or

c the consideration is higher than the open market value and the supplier does not have a full right to a VAT deduction.

In these cases, the corresponding taxable amount for VAT purposes should be the open market value (as defined in Article 16, No. 4 of the VAT Code), with the value of the consideration being disregarded.

X OUTLOOK AND CONCLUSIONS

Portuguese legislation has already implemented some of the recent OECD recommendations, namely, the hierarchy of transfer pricing methods has been removed (OECD Guidelines 2017) and country-by-country reporting has been introduced (BEPS Action 13). However, specific progress concerning BEPS Actions 8–10 and the documentation format (master and local files) recommended by BEPS Action 13 are still expected.

In practical terms, new concepts and principles (such as value creation and substance principles) introduced by the OECD through the BEPS Actions 8, 9, 10 and 13 and other recent OECD guidance have been gradually adopted and implemented by Portuguese taxpayers and the Portuguese tax authorities. However, without prejudice to the use of OECD Guidelines as an interpretative instrument, in compliance with the constitutional principle of tax legality and for clarity's sake, those new concepts and principles are expected to be reflected in Portuguese tax legislation in the near future.

Additionally, in the context of the taxation of digital economy, structural changes on transfer pricing principles at an international level (OECD/G20 and EU) are expected before long, which will also imply new updates on domestic legislation.

In addition to the expected law changes, the Portuguese tax authorities are particularly focused on transfer pricing issues and consequently have been increasing the number of tax inspections and becoming more sophisticated in these matters (training tax inspectors on transfer pricing issues and looking to international practices for inspiration). We also expect an increase of scrutiny focused on the transfer pricing policies adopted by taxpayers in the context of covid-19 outbreak.

8 See Article 16, Nos. 10–12 of the VAT Code, which transposed Council Directive No. 2006/69/EC, 24 July 2006, with effect as of 1 January 2012.

All this, combined with the strengthening of mechanisms of exchange of information (namely MDR) and country-by-country reporting, translates into new challenges for taxpayers entering into transactions with related entities, as well as an increase in the legal and economic complexity of transfer pricing matters.

In summary, we are witnessing an increase in the importance of transfer pricing matters and we expect such importance to increasingly grow in the coming years, namely through:

a internal legislative changes adopting OECD recommendations (not only the existing ones but also the expected ones);

b issuance of new OECD recommendations and EU rules, addressing the challenges of digitalisation of the economy;

c an increase in scrutiny by the tax authorities, leading to tax inspections and litigation related to transfer pricing matters (further enhanced by an expected massive review of transfer pricing policies adopted by taxpayers as a result of the covid-19 outbreak); and

d as a natural consequence of all the above, an increase in the expenditure of time and financial resources by taxpayers to comply with transfer pricing requirements.

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