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**Establishing Businesses/Investments Offshore: Investment in Countries Outside the US: Key
Issues Around the Formation of Business Entities and Joint Ventures Abroad (illustrated by
examples and also to cover tax developments)**

Portuguese Perspective

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Table of Contents:

1. Introduction
2. Portuguese Legal Background
3. Key Issues on the Formation of Businesses and Joint Ventures in Portugal
 - 3.1. The choice of the investment vehicle
 - 3.1.1. To set up a Company or a Joint Venture (“JV”)?
 - 3.2. Portuguese Companies
 - 3.2.1. Most used types of companies
 - 3.2.2. Incorporation requirements
 - 3.3. JV structures
 - 3.4. Branch
 - 3.4.1. Representative Office
4. General Overview of Tax, Labor, Corporate Governance and Other Relevant Laws
 - 4.1. Portuguese Taxation
 - 4.1.1. Corporate Income Tax
 - 4.1.2. Tax Incentives
 - 4.1.2.1. Portuguese Investment Tax Code
 - 4.1.3. VAT
 - 4.1.4. Portuguese Tax Treaties.
 - 4.1.4.1. U.S.-Portugal Tax Treaty
 - 4.1.5. Non-habitual Tax Resident
 - 4.2. Labor Law
 - 4.3. Corporate Governance
 - 4.3.1. Golden Parachutes
 - 4.3.2. Shareholders right to vote on executive pay
5. Examples of Structures Used By U.S. Companies To Conduct Business in Portugal

1. Introduction

This paper was specially prepared for the NYSBA-UIA, Joint-Seminar in New York City, September 13 – 14, 2010.

This Paper will provide a general overview on the Key Issues Around the Formation of Business Entities and Joint Ventures in Portugal and provide general information on the Portuguese legal framework.

This paper provides general information only and does not constitute any type of legal advice on the subjects referred to below, and therefore no liability is accepted for loss which may arise from reliance on information contained in this paper.

2. Portuguese Legal Background

The Portuguese legal system is a typical continental codified system with fixed written rules that are mainly enacted by the Parliament (“Laws”) or by the Government (“Decree-Laws”). In Portugal, Courts have the main purpose of construing the law and resolving disputes under such law.

Contrary to the common law systems, Portuguese Courts are mainly interpreters of the law and their decisions provide only guidelines and general concepts of the law. Court decisions do not constitute law under the Portuguese system.

There is no system of precedent in Portugal and, in general, the Courts are not required to follow previous decisions from other Courts, with the exception of some decisions from the Supreme Court (*Assentos*) that settle the official interpretation of certain particular law, and must be followed in other Courts’ decisions. Nevertheless, there is a tendency for the courts to follow other Courts’

decisions and rulings on similar cases.

Under the principle of contractual freedom (*Liberdade Contratual*), established in article 405 of the Portuguese Civil Code (“Civil Code”), within the limits of the law, parties have the freedom to determine the content of a contract, its clauses, and to execute different types of contracts classified or not under the Civil Code.

3. Key Issues on the Formation of Businesses and Joint Ventures in Portugal

3.1. The choice of the investment vehicle:

3.1.1. To set up a Company or a Joint Venture (“JV”)?

Traditionally, investors in Portugal tend to use less JV’s and conduct their investments by way of incorporation of a company (SPV or Special Purpose Vehicle), in one of the three types of limited liability companies, i.e. the Private Limited Company, the Sole Proprietorship Private Limited Company or the Corporation. Usually, the choice is made in consideration of the complexity of the investment and the amounts involved. In these situations, partners opt to regulate the rights and obligations inside the SPV, by execution of a Shareholders Agreement.

3.2. Portuguese Companies

3.2.1. Most used types of companies

In view of the various legal structures available according to the Portuguese Companies Code (*Código das Sociedades Comerciais*), investors have generally chosen among the three existing types of limited liability companies: the Private Limited Company (*Sociedade por Quotas - “Lda.”*), the Sole Proprietorship Private Limited Company (*Sociedade Unipessoal*) or the Corporation (*Sociedade Anónima - “S.A.”*). In summary:

- Private Limited Company: an Lda. requires a minimum of 2 quotaholders and a minimum capital of 5,000€. This type of company requires the appointment of at least

one manager (*gerente*) and, when appropriate, and under certain conditions, an auditor must also be appointed, and who must be a chartered accountant (*Revisor Oficial de Contas*). In these companies, the quotaholders are not liable for any obligations of the company when such is not specifically provided for in the company's by-laws and their exposure to third party liability is limited to their capital contribution in the company. The Private Limited Company is the most common type of company in Portugal;

- Sole Proprietorship Private Limited Company: requires only 1 quotaholder and a minimum capital of 5,000€. This type of company requires the appointment at least one manager (*gerente*). The quotaholder may be an individual or a company. However, the individual quotaholder is not allowed to participate in more than one sole proprietorship company. The sole proprietorship company may not be the sole quotaholder of another sole proprietorship company; and,
- Corporation: a S.A. requires a minimum of five shareholders and minimum capital of 50,000€. This company may issue bearer shares provided all the share capital is fully paid up. Non-voting preference shares may be issued up to a maximum of 50% of the share capital. Redeemable preference shares may also be issued provided they are fully paid up. The management of these companies must be guaranteed by a board of directors (*Conselho de Administração*) consisting of an odd or pair number of members (*Administradores*). If the capital does not exceed 200,000€, Corporations are only required to have a single director. A chartered accountant must be appointed in this type of company

3.2.2. Incorporation requirements

In order to incorporate a company, the first step is to apply for a corporate name certificate at the National Company Registry Office (the “RNPC”). In order to facilitate the approval it is better to choose three potential company names. The corporate name application must contain one of the partners' name, the legal structure of the company to incorporate, the location of its registered office

and the corporate object. Upon approval of the company name, a provisional tax identification number is immediately granted to the company to be incorporated.

After having the corporate name certificate duly issued, the company should be incorporated by means of a private contract or public deed. The share capital should already be deposited in a Bank or, alternatively, it is also possible to deposit the share capital within 5 days subsequent to the execution of the incorporation contract.

The incorporation contract must be registered at the Commercial Registry Office. Subsequently it is necessary to register the company before the Tax Office and also before the Social Security.

The timeframe for incorporation will depend on the availability of the necessary documents (corporate name certificate, identification and representation of the shareholders/quotaholders duly legalized, drafting of the by-laws and private agreement for incorporation), but it can take approximately 5 business days.

In addition, Portuguese companies may also be incorporated through a fast track procedure (the company is incorporated on one day) named “*Empresa na Hora*”, which allows a speedier incorporation. However, such procedure has certain relevant restrictions, namely, shareholders may only choose pre approved names and pre approved articles of association (without possibility of any changes being made to either one before incorporation).

3.3. JV structures

Under Portuguese law there are certain special forms for joint ventures, such as the Complementary Group of Enterprises (*Agrupamento Complementar de Empresas*), Consortium (*Contrato de Consórcio*) or the Unincorporated Partnership (*Contrato de Associação em Participação*).

We shall briefly address the above special forms of joint ventures:

- Complementary Group of Enterprises (*Agrupamento Complementar de Empresas*) (“CGE”)

The Complementary Group of Enterprises is the oldest form of joint venture in Portugal. The legal framework of CGE is regulated by Law No. 4/73, June 4 and Decree-Law No. 430/73, August 25, last amended by Decree-Law No. 76-A/2006, March 29. Parties (two or more, individuals, and/or legal entities and/or companies) may incorporate a CGE in order to improve its conditions of exercise or the result of its economic activities, but obtaining and distributing profits cannot be main purpose of the venture.

The CGE may or not have a capital and must be incorporated by means of a written agreement (if the capital is comprised of assets for which the law requires public deed for their transfer, then the incorporation of the CGE must be by means of a public deed) and is subject to commercial registration at the local competent Commercial Registration Office. The management of the CGE is exercised by one or more persons designated in the contract and a chartered accountant must be appointed in case the CGE has issued bonds.

- Consortium (*Contrato de Consórcio*)

The Consortium is the type of agreement most often used in Portugal for joint ventures. The legal framework of this agreement is regulated by Decree-Law No. 231/81, July 28. Parties (two or more, individuals or companies) under this agreement undertake to carry out jointly a certain activity or to act jointly in order to achieve a common purpose. The Consortium purpose will vary taking into consideration the nature of the venture, namely, preparing and /or implementing a given project or undertaking, supplying of goods to third parties, promoting research, producing goods to be shared amongst the members of the consortium, etc.

The Consortium formalities shall depend on the assets that are transferred into the venture. In case a property is transferred into the venture, incorporation of the Consortium should be made by means of a public deed, otherwise, only a written agreement is required.

- Unincorporated Partnership (*Contrato de Associação em Participação*)

The Unincorporated Partnership is a type of agreement used in Portugal as an alternative for joint ventures. The legal framework of this Partnership is also regulated by Decree-Law No. 231/81, July 28. Under this agreement one or more individuals or entities (hidden partners) share the profits or the profits and losses incurred by another individual or entity (operational partner) in carrying out a certain commercial activity.

This type of agreement is not subject to any special formality, unless otherwise required by law with regard to the nature of the assets contributed by the hidden partner to the partnership.

3.4. Branch

A branch is not a separate legal entity and when a company creates a branch, it is held responsible for the entire assets and liabilities of that branch. In order to incorporate the branch it is necessary to submit: proof of legal existence of the company that creates the branch; the by-laws of such company; the deliberation of creation of the branch; and indication of the branch's representative and documents identifying the applicant and its powers for such purpose.

The registration of a branch may also be executed by means of a fast track procedure called "Sucursal na Hora". With this procedure, it is possible to incorporate a branch in one day and in a single act in the Commercial Register.

3.4.1. Representative Office

Under Portuguese Law the representative office is a type of branch/office that is expressly foreseen in the law only for insurance, credit and financial institutions. A representative office activity is limited to representation and information tasks to the represented institution and cannot perform financial operations or acquire shares or parts of capital in Portuguese companies, nor acquire properties other than the ones that are indispensable for their installation and work.

The representative office of banks and financial institutions must be duly registered before the Bank of Portugal and of insurance companies before the ISP - Insurance Institute of Portugal. In addition to the documentation that is necessary for the registration of a branch in Portugal, it is required to present a certificate issued by the supervising authorities of the country of origin stating the regime of the institution (by reference to the applicable law).

4. General Overview of Tax, Labor, Corporate Governance and Other Relevant Laws

4.1. Portuguese Taxation

4.1.1. Corporate Income Tax

The Portuguese Corporate Income Tax is a progressive tax, which's rates vary from 12.5% to 25% of the taxable profit, the first rate being applicable to the first 12,500 EUR of taxable profits and the second rate to the remaining taxable profits.

A local surcharge tax may be levied on taxable profits before the deduction of any carried-forward tax losses, at a maximum rate of 1.5%. The maximum corporate income tax is 26.5% of the net profits. It may be higher if the company is carrying forward tax losses, since it cannot offset the tax losses against the local surcharge tax. This surcharge is calculated based on the Corporate Income Tax generated in each of the municipalities, which have the power to fix the rate in their own municipality.

Additionally, as of 2010, a State Surcharge of 2.5% is applicable over the taxable profits derived by resident companies that are higher than 2,000,000€.

4.1.2. Tax Incentives

Portuguese tax incentives for corporate income tax purposes are established throughout the Portuguese tax legislation, i.e. the Corporate Income Tax Code (“CIRC”) and the Tax Incentives Statute (“EBF”), and relevant applicable decree-laws, as well as in legislation enacted by the autonomous regions of the Azores and Madeira. We shall briefly mention only the most important incentive regime under national legislation.

4.1.2.1. Portuguese Investment Tax Code

In order to provide a legal approach to a new spirit of competitiveness of the economy, aiming to stimulate the national economy and the Portuguese entrepreneurs, Decree-Law No. 249/2009, of September 23, among other measures approved the Investment Tax Code and amended Article 41 of the Statute of Tax Benefits.

The Investment Tax Code, effective since January 1, 2009, regulates the contractual, conditioned and temporary tax incentives that can be granted under the terms of Article 41 of the Statute of Tax Benefits, to productive investments executed in Portugal and to the internationalisation of Portuguese companies. Tax benefits regulation foresees its grant to companies that promote investment projects to be executed until 2020, that are relevant for the Portuguese entrepreneurs and that are part of sectors with strategic interest for the Portuguese economy. Under the terms of Article 2 (2) of this code, the investment projects must have their object within the following economic activities:

- Extractive industry and transformative industry;
- Tourism and activities declared of interest for tourism under the terms of the applicable legislation;
- Activity and connected services of technology;

- Agricultural, fishing, cattle and forestry activities;
- I&D activities and high-tech;
- Information technologies and production of audiovisual and media;
- Environment, energy and telecommunications.

4.1.3. VAT

A value added tax system (“VAT”) according to the EU Sixth Directive is applicable, which’s standard rate is 21% and is applicable to the majority of goods and services. In addition, there is an intermediate rate of 13% and a reduced rate of 6% that are applicable to a limited range of goods and services.

In the Azores and Madeira archipelagos, the VAT rates are levied at 15%, 9% and 4%, respectively, on the same supplies.

4.1.4. Portuguese Tax Treaties

Portugal has entered into more than 50 anti-double taxation treaties. The anti-double taxation treaties entered into by Portugal follow the Organization for Economic Cooperation and Development (OECD) Model Convention on Income and on Capital.

The double taxation treaties entered by Portugal generally apply either the tax exemption or ordinary credit method. In broad terms, under the tax exemption method the residence state shall compute the tax on the basis of the taxpayers’ worldwide income and exempt the proportion that relates to foreign derived income, whereas under the credit method the residence country of the taxpayer shall credit the tax levied at the source country against the taxes computed over the same income according to its own tax provisions.

Currently Portugal has anti-double taxation treaty in force with the following countries: Algeria,

Austria, Belgium, Brazil, Bulgaria, Canada, Cape Verde, Chile, China, Cuba, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Guinea-Bissau, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Korea, Latvia, Lithuania, Luxembourg, Macau, Malta, Mexico, Morocco, Mozambique, Netherlands, Norway, Pakistan, Poland, Romania, Russia, Singapore, Slovakia, Slovenia, Spain, Sweden, Switzerland, South Africa, Tunisia, Turkey, Ukraine, United Kingdom, United States and Venezuela.

4.1.4.1.U.S.-Portugal Tax Treaty

Portugal has entered into anti-double taxation treaty with the United States of America, which is in force since January 1, 1996.

Pursuant to this Treaty, beneficiaries are subject to reduced withholding rates, as follows:

Dividends	Interests	Royalties
5% ⁽ⁱ⁾ 15% ⁽ⁱⁱ⁾	10%	10%

⁽ⁱ⁾ When the shareholder is a company which during 2 consecutive years previous to the payment of the dividend, holds directly 25% or more of the share capital.

⁽ⁱⁱ⁾ For all other cases.

4.1.5. Non-Habitual Tax Resident

Back in 2009, a new category of resident individuals was approved, creating a more favorable tax regime – the non-habitual tax resident regime.

The non-habitual tax resident regime is applicable to any individual who meets the general residency criteria established in the IRS (individual income tax) Code, provided such individual has not been deemed a Portuguese tax resident in the preceding five years.

The non-habitual tax resident status is maintained for a period of ten consecutive and renewable

years.

The benefits of this regime include: (i) the taxation of employment and professional or business income at a 20% flat rate in the case of scientific, artistic or technical activities deemed of high value-added as approved by Implementing Order no. 12/2010, of 7 January; and (ii) in certain cases the application of the tax exemption method of income from employment, business and professional activities, capital, real estate, capital gains and pensions, derived outside Portugal.

4.2. Labor Law

Currently, employment matters are mainly regulated by the Portuguese Labor Code which compiles into one single Code, in a more systematic and compound way, the most important labor rules.

The Portuguese labor market is very rigid and there is no balance of positions between employers and employees. On the contrary, there is a high level of workers' protection, concerning for example, the prohibition of dismissals unless due to just cause (subjective or objective). Portuguese labor law also protects illness situations, gender equality, protection of maternity and paternity, entitlement to professional training, restriction to the execution of fixed-term contracts. Labor law allows short-term contracts grounded on starting-up of a business enterprise, renewable up to 2 years at the employer's option. After this period, the employee is either granted a permanent labor contract or the contract is terminated.

The normal working week schedule has 40 hours of work, distributed from Monday to Friday, on an 8 hours per day basis. All employees are entitled to 22 working days of vacation per year (plus an additional period up-to 3 days per year as a special assiduity reward), sick leave and maternity leave are also applicable.

Unless differently established by labor collective agreement, overtime is payable with a 50%

increase on the first hour and a 75% increase thereafter. Overtime worked during rest days is payable with a 100% increase.

As a general rule, wage negotiations take place between representative bodies of both employer and employee. Although strikes are permitted by law, they are practically non-existent.

4.3. Corporate Governance

The Portuguese Companies Code (“CSC”) sets a number of legal requirements applicable to all companies that include rules on disclosure of information to shareholders, appointment of directors (including minority rights on appointment of directors), exercise of voting rights in shareholders meetings, powers of the supervisory board, among others. Hot topics such as the golden parachutes and shareholders right to vote on executive pay are also regulated by the CSC.

4.3.1. Golden Parachutes

The Portuguese legal system does not have a tradition of Golden Parachutes for their executives.

In the absence of a rule in the company by-laws, managers of an *Lda.* that are dismissed without just cause are entitled to be indemnified for the losses suffered, but only to a maximum of 4 years or of the remaining period of their mandate, if shorter.

Dismissal without just cause of members of the board of directors of a *S.A.* also entitles the dismissed director to be indemnified for the losses suffered in accordance with his agreement or in the general terms of law, but this compensation cannot exceed the amount of the remunerations that he would presumably be receiving until the term of his office.

4.3.2. Shareholders right to vote on executive pay

The remuneration of board members of a *S.A.* should be approved by a shareholders resolution or by a remunerations committee that is designated by a shareholders resolution. The remuneration package may be predetermined or include a bonus system with a percentage on the company profits. The maximum percentage that can be distributed to board members must be authorized in the company by-laws and may not include the distribution of company reserves or any part of the company profits that are considered as undistributed in accordance to the law.

The remuneration of managers of an *Lda.* should also be approved by a quotaholders resolution. Unless there is a special provision in the by-laws, the remuneration of the managers of an *Lda.* cannot include a bonus system (total or partial) with a percentage on the company profits.

In the case of listed companies, specific Corporate Governance Guidance Documents have been published by the Securities Market Commission (*Comissão do Mercado de Valores Mobiliários – “CMVM”*). Mandatory obligations are also in place concerning the disclosure of shareholdings by members of the board of directors and supervisory board, publication of annual reports on corporate governance, internet website, disclosure of material information on the company business, stock option plans. Regulation No. 1/2010 of the CMVM further requires listed companies to disclose stock option plans to the CMVM within seven days of approval.

5. Examples of Structures Used By US Companies To Conduct Business in Portugal

The methods for conducting businesses in Portugal vary pursuant to the investors needs. In most cases, international companies tend to acquire businesses already existing in Portugal.

- Example 1: A US based international company in the sector of Office Supplies (Staples, Inc.) decided to enter the Portuguese Market.

The US investor entered the Portuguese Market in 1999, and for such purpose it decided to acquire the business of a competing international company which was in the Portuguese Market since 1996. The acquisition by the US investor was carried out by the incorporation of a Portuguese subsidiary who then acquired 100% of the Office Supplies business of the competing company.

As of 2010, the US investor carries on its activity by means of the initially incorporated company and is currently the largest office supply retailer in the Portuguese Market.

- Example 2: A US based company (Computer Sciences Corporation) decided to conduct business in Portugal.

The US based company initially created a branch in Portugal through a European subsidiary. Following an initial period, and considering the increase in activity in Portugal as well as in revenue, it was decided to incorporate a subsidiary which then merged with the existing branch.

With the incorporation of the subsidiary, it was possible to separate the Portuguese activity from the parent's activity and therefore avoid the liabilities associated with the existence of a branch.

- Example 3: A US based company (Dayton Progress, Corporation) decided to build a factory in Portugal for the manufacturing of precision tools.

The US based company decided to incorporate a new company using a European subsidiary as a partner. Considering that the US investor had the intention of building a factory for the manufacturing of precision tools, it was decided to apply for a financial incentive in Portugal within the “Business Modernization Incentive System” program (*Sistema de Incentivos à Modernização Empresarial*).



The financial incentive granted was *circa* € 5M, in order to partially finance the building and equipment of the factory for manufacturing precision tools.

The attribution of the financial incentive to the US investor was based on the obligation of creating and maintaining 45 jobs in Portugal and guaranteeing the constant training of the employees for a determined period of time. The US investor also had to comply with a certain minimum sales value.
