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Update

Tax

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Portugal/Sweden Double Taxation Treaty to be terminated

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Swedish Parliament has, last Wednesday, voted in favour of the Government's proposal to terminate Sweden's Double Taxation Treaty ("DTT") with Portugal.

The reason for terminating the agreement is that the country has not yet introduced the amended provisions that the two countries agreed on in May 2019.

Such changes were mostly focused on the taxation of private pensions.

Under Swedish internal tax law, pensions should be taxed in Sweden if they are paid out from Sweden to a person who lives abroad. However, the DTT with Portugal states that certain pensions cannot be subject to tax in Sweden if the individual receiving them lives in Portugal.

Thus, following negotiations with Portugal in 2019, both countries agreed on a Protocol which would change the DTT to allow Sweden to claim tax on pensions from private pensions. Nonetheless, up to this date, Portugal did not fulfil the internal formalities in order to ratify this Protocol and, thus, the same did not come into force.

As a result, Swedish Parliament has now decided to terminate the DTT with Portugal as of 1 January 2022. Sweden should now officially notify Portugal of the termination of the DTT.

Once such official notification takes place, in principle, as 1 January 2022, Sweden is entitled to claim tax on all income paid out by Swedish entities and individuals to Portuguese tax residents, be it companies or individuals. On the other hand, Portugal is also entitled to claim tax on all income paid out to Swedish entities and individuals.

For instance, income arising from a simple rendering of services by a Swedish company to a Portuguese company will be subject to withholding tax, at a 25% rate, under Portuguese tax law. Since the DTT will be terminated, there will be no legal mechanism to mitigate or eliminate this tax burden.

Similarly, in what concerns individuals, such as pensioners, for example, Sweden will be entitled to claim tax on all pensions (private and public) paid out to individuals living in Portugal.

In order to avoid a double taxation, Portuguese tax law grants domestic companies and individuals residing in the country the possibility to offset, within certain limits and subject to determined conditions, the tax paid abroad to the income tax due in Portugal.

Such deduction will correspond to the lower of the following amounts:

1. Income tax paid abroad;
2. Fraction of the income tax, calculated before deductions, corresponding to the income that may be taxed in the source country, net of the specific deductions provided for in Portuguese tax legislation.

Whenever it is not possible to make the deduction referred to in the tax year in which the income obtained abroad was obtained, the remainder deduction may be carried-forward to be offset in the five following tax years, also subject to certain limits.

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SÉRVULO's Scandinavian Desk will continue accompanying this subject and will provide any updates as they arise.

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