EXPLANATORY MEMORANDUM TO

THE DOUBLE TAXATION RELIEF AND INTERNATIONAL TAX ENFORCEMENT (PORTUGUESE REPUBLIC) ORDER 2025

2025 No. [XXXX]

1. Introduction

1.1 This Explanatory Memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 Dan Tomlinson MP, Exchequer Secretary to the Treasury at His Majesty's Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 James Dunstan, Deputy Director for Business Assets & International at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Scott McCartney at HMRC can be contacted by email at the following address with any queries regarding the instrument: taxtreaty.team@hmrc.gov.uk. Alternatively, the department can be contacted by telephone: 03000 515978.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 The instrument brings into effect a Convention (the "2025 Arrangements") agreed by the United Kingdom and Portugal. The 2025 Arrangements replace the existing arrangements (the "1969" Arrangements) between the two Governments for the Avoidance of Double Taxation with respect to Taxes on Income and Capital Gains which will cease to have effect.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The purpose of Double Taxation Conventions (DTCs) is to prevent income or gains being taxed both in the territory in which they arise and the territory in which the recipient is resident. They do this either by allocating an exclusive right to tax the income or gain to one of the territories, or by providing that one territory must give relief for the tax charged in the other territory in respect of the same income or gain. DTCs also provide additional protection for taxpayers by including specific measures that combat discriminatory tax treatment. More generally, DTCs benefit taxpayers by

ensuring certainty of treatment and, as far as possible, by reducing compliance burdens.

5.2 Like all of the United Kingdom's more recent DTCs, the 2025 Arrangements largely follow the Organisation for Economic Cooperation and Development's (OECD) latest Model Tax Convention on Income and on Capital (OECD Model), with any necessary departures explained below. In doing so, they encourage and maintain international consensus on the appropriate tax treatment of cross-border economic activity, promoting international trade and investment.

5.3 DTCs also protect the Exchequer by including provisions to combat tax avoidance. For example, measures providing for the exchange of information between revenue authorities make it more difficult for residents of both territories to evade taxation by concealing assets offshore.

5.4 The 2025 Arrangements include the minimum standards recommended by the OECD/G20 Base Erosion and Profit Shifting (BEPS) project. The BEPS project created a single set of consensus-based international tax rules to protect against tax avoidance while offering increased certainty and predictability to taxpayers. These provisions are now included in the 2017 version of the OECD Model.

What was the previous policy, how is this different?

5.5 The previous DTC between the United Kingdom and Portugal entered into force in 1969. This instrument gives effect in the United Kingdom to the provisions of the new DTC. The 2025 Arrangements make changes to taxing rights on dividends, interest and royalties and eliminate withholding taxes on these in some situations where the relevant criteria are met. The 2025 Arrangements also include provisions which ensure that the United Kingdom can tax gains made by residents of Portugal on indirect holdings of immovable property situated in the United Kingdom.

5.6 The following paragraphs in this section explain the provisions of the 2025 Arrangements including the reasons for material departures from the OECD Model.

Title and preamble

5.7 The title and preamble of the 2025 Arrangements follow the latest OECD Model. The change to the OECD Model arose from the BEPS Action 6 Report on preventing the granting of treaty benefits in inappropriate circumstances. The statement in the preamble that the territories intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements, is one of the elements of the minimum standard on preventing treaty abuse agreed under the BEPS project.

Article 1 (Persons covered)

5.8 Article 1 sets out the general scope of the 2025 Arrangements, which will apply to residents of the United Kingdom and residents of Portugal, as defined by Article 4 of the 2025 Arrangements.

Article 2 (Taxes covered)

5.9 Article 2 lists the taxes to which the 2025 Arrangements are to apply. The existing United Kingdom taxes to which the 2025 Arrangements will apply are income tax, corporation tax and capital gains tax. The existing Portuguese taxes to which this Convention will apply are the personal income tax (*Imposto sobre o Rendimento das*

Pessoas Singulares – IRS), the corporate income tax (*Imposto sobre o Rendimento das Pessoas Coletivas* – IRC); and the surtaxes on corporate income tax (*derramas*).

Article 3 (General Definitions)

5.10 Article 3 defines a number of terms used in the 2025 Arrangements and provides a rule for determining the meaning of terms not defined. For the most part, changes from the 1969 Arrangements reflect changes in the OECD Model. The United Kingdom uses a definition of "national" that differs from the OECD Model in order to reflect more accurately the provisions of its domestic law.

Article 4 (Resident)

5.11 Article 4 establishes the meaning of "resident of a Contracting State" and lays down detailed rules for resolving cases where individuals or other persons may be considered residents of both territories for tax purposes under their domestic laws. Unlike the OECD Model, the provisions of paragraph 1 include reference to "place of incorporation" as this condition establishes company residence under the domestic laws of the United Kingdom.

Article 5 (Permanent establishment)

5.12 Article 5 defines the term "permanent establishment" (PE) for the purposes of the 2025 Arrangements. Taken together with Article 7, it describes the circumstances and manner in which enterprises of one territory may be taxed on their business profits arising in the other. Compared to the 1969 Arrangements the new Article slightly expands the list of activities not to be considered a PE. The new Article also includes in paragraph 5 a rule recommended by the BEPS project that prevents companies from fragmenting their activities in order to avoid the PE threshold.

5.13 Consistent with the position adopted by the United Kingdom, under the Multilateral Convention to Implement Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS MLI), the United Kingdom and Portugal agreed not to adopt the other amendments to the definition of PE recommended by the BEPS project.

Article 6 (Income from immovable property)

5.14 Article 6 allows the territory in which the property is situated to tax income from immovable property. It also defines immovable property. The Article materially replicates the equivalent provisions of the OECD Model and there are no material changes from the equivalent provision in the 1969 Arrangements.

Article 7 (Business profits)

5.15 Article 7 provides that unless an enterprise of one territory carries on business in the other through a PE situated there, its profits will be taxable only in its territory of residence. Where the enterprise has a PE in the other territory, that territory will be entitled to tax profits attributable to the PE. The provisions of this Article in the 2025 Arrangements follow the OECD Model provisions from 2008, and not the newer approach adopted in 2010. This was at the request of Portugal in order to align with their domestic law, and is acceptable to the UK.

Article 8 (Shipping and air transport)

5.16 Article 8 governs the taxation of shipping and air transport operated in international traffic. It follows the OECD Model in providing that profits of an enterprise of one

territory from the operation of ships or aircraft in international traffic shall be taxable only in that territory.

Article 9 (Associated enterprises)

5.17 Article 9 governs the evaluation for tax purposes of transfers of goods, services, finance and intangible property between associated enterprises. It is based on the "arm's length" principle, which requires such transfers to be evaluated as if they had taken place between independent enterprises.

5.18 The Article replicates the OECD Model and includes a paragraph 2 which determines that where an adjustment is made to the profits of an enterprise by one territory, the other territory will make an appropriate corresponding adjustment to the amount of tax charged on those profits, in order to relieve the double taxation which might otherwise arise as a result of an adjustment by only one territory. Paragraph 2 was introduced into the 1969 Arrangements through the BEPS MLI.

Article 10 (Dividends)

5.19 Article 10 contains the rules for the taxation of dividends paid by a company that is a resident of one territory to a resident of the other territory. It allows the territory where the company paying the dividend is resident to tax the dividend but where the beneficial owner of the dividend is resident in the other territory the rate of tax is limited to 10% of the gross amount of the dividend by sub-paragraph 2(a). However, in line with United Kingdom preferences, sub-paragraph 2(b) allows for a rate of 15% when the entity paying the dividend is a Real Estate Investment Trust. This protects the United Kingdom's ability to tax income derived from UK property when investors invest through a Real Estate Investment Trust.

5.20 Notwithstanding paragraph 2, paragraph 3 provides that where the dividend is paid to a company which has owned more than 10% of the capital of the paying company for at least one year, then the dividend can only be taxed in the country where the dividend is received. This materially replicates the provisions of the EU Parent-Subsidiary Directive, and will reduce the tax burden for UK direct investors in Portuguese companies.

Article 11 (Interest)

5.21 Article 11 contains the rules for the taxation of interest arising in one territory and paid to a resident of the other territory. It provides that a territory may tax interest arising there but where the interest is beneficially owned by a resident of the other territory the rate of tax is limited generally to 10% except where it is paid or received by the other state, a political subdivision or the central banks, in which case it is exempt from tax, or by a bank resident in the other state, in which case the rate of tax is limited to 5%. In the 1969 Arrangements interest could be taxed at 10% in all cases.

5.22 The definition of interest departs from the OECD Model to reflect the United Kingdom's preference for clarifying that the Article does not apply to amounts that are within the definition of a dividend in Article 10.

5.23 Unlike the OECD Model, the "special relationship" provision at paragraph 8 applies where the amount of interest paid is excessive "for whatever reason". This permits the territories to take into account both the rate of the interest and the amount of the debt in determining whether interest paid is excessive. In other respects, the Article largely follows the OECD Model.

Article 12 (Royalties)

5.24 Article 12 contains the rules for the taxation of royalties paid by a resident of one territory to a resident of the other territory. In line with Portugal's preferences, it provides that the territory where royalties arise may tax the royalties but where the royalties are beneficially owned by a resident of the other territory, the rate of tax that may be charged is limited to 5%. This replicates the 1969 Arrangements.

5.25 Paragraph 5 provides a sourcing rule, deeming that the royalty arises in the state where the payer is resident. This is required when both states are permitted to tax the royalty.

5.26 Unlike the OECD Model, the "special relationship" provision at paragraph 6 applies where the amount of royalty paid is excessive "for whatever reason". This permits the territories to take into account all circumstances in determining whether the royalty paid is excessive. In other respects, the Article largely follows the OECD Model

Article 13 (Capital Gains)

5.27 Article 13 contains the rules for the taxation of gains deriving from the alienation of property situated in one territory by a resident of the other. The 2025 Arrangements include a paragraph 2 which allows for non-residents to be taxed on gains arising from the sale of shares in property rich companies. This is required to protect the UK's Offshore Property Developers and Non-Resident Capital Gains tax legislation. It mirrors the OECD Model in all material aspects, barring a reordering of the paragraphs.

Article 14 (Income from employment)

5.28 Article 14 contains the rules for the taxation of employment income and follows the OECD Model. There is no material change from the 1969 Arrangements.

Article 15 (Directors' fees)

5.29 Article 15 follows the OECD Model and provides that directors' fees may be taxed in the territory of which the company paying them is a resident. This provision was not present in the 1969 Arrangements, and the situation would have been dealt with under Article 15 (Employments). This reflects the development of the OECD Model.

Article 16 (Artistes and sportsmen)

5.30 Article 16 contains the rules for the taxation of income derived from personal activities as an entertainer or sportsperson and materially replicates the OECD Model. The second paragraph, which provides that the state in which the activities took place can tax income accruing to a third person, was not present in the 1969 Arrangements.

Article 17 (Pensions)

5.31 Article 17 states that pensions and other similar remuneration paid to a resident of a Contracting State shall be taxable only in that State, replicating the OECD Model.

Article 18 (Government service)

5.32 Article 18 contains rules for the taxation of remuneration paid to an individual in respect of government service, including pensions. The general rule is that the remuneration is only taxable in the territory to which the services are rendered, in line with the OECD Model. However, there is an exception for remuneration where the

recipient is a national of the other state, in which case both states are permitted to tax and the state of residence will give relief. This is in line with Portugal's preferences.

Article 19 (Students)

5.33 Article 19 contains the rules which govern the taxation of visiting students and business apprentices. Its provisions follow the OECD Model. The Article differs slightly from the 1969 Arrangements in that it no longer provides for a 183-day tax-free period for students undertaking employment to gain practical experience directly related to their studies.

Article 20 (Other income)

5.34 Article 20 contains the rules for the taxation of income not dealt with elsewhere in the 2025 Arrangements. Paragraphs 1 and 3 broadly replicate paragraphs 1 and 2 of the OECD Model. Paragraph 2 contains a special provision to allow for the operation of UK domestic legislation relating to the taxation of overseas trusts: this is a UK preference. Paragraph 4 includes a "special relationship" provision similar to that found in Articles 11 and 12.

Article 21 (Elimination of double taxation)

5.35 Article 21 sets out the methods by which each territory will relieve double taxation and is broadly based on the equivalent article in the OECD Model, modified to reflect each territory's domestic double taxation relief rules. Paragraph 1 sets out the provision applying to Portugal and provides for relief by way of credit for United Kingdom tax paid. Paragraph 2 details the corresponding provisions that apply in the United Kingdom, which generally provide for relief by way of credit, but also include provisions that exempt dividends and the profits of PEs from tax in line with domestic law.

5.36 Paragraph 3 provides for a deemed source rule, which clarifies that payments taxed in accordance with this provision and belonging to a resident of one of the states are deemed to arise in the other state. Paragraph 4 removes the obligation for the United Kingdom to provide relief for Portuguese tax in the unusual situation where the income in question is taxable in Portugal solely because it is income of a resident of Portugal. Portugal did not require an equivalent provision due to their domestic laws. Paragraph 5 allows for the operation of 'exemption-with-progression', meaning that tax exempted under the 2025 Arrangements can still be taken into account for the purposes of calculating the appropriate taxation band under domestic law.

Article (22 Non-discrimination)

5.37 Article 22 provides that, subject to certain conditions, neither territory shall impose discriminatory taxes or connected requirements on the nationals, PEs and enterprises of the other. In line with United Kingdom preferences, paragraph 5 deals separately with personal allowances granted to residents and nationals, confirming that the Article does not require these to be granted to such persons where they are not resident in the territory in question. The Article omits the OECD Model paragraph 6, which extends the application to taxes of every kind and description – therefore its scope is limited to the taxes described in Article 2 in line with UK preference.

Article 23 (Mutual agreement procedure)

5.38 Article 23 establishes a procedure for resolving difficulties arising from the interpretation or application of the 2025 Arrangements and meets the minimum

standard on improving dispute resolution agreed under Action 14 of the BEPS project. Paragraph 5 provides for mandatory binding arbitration, the detailed provisions for which are contained in paragraph 2 of the Protocol to the 2025 Arrangements.

Article 24 (Exchange of information)

5.39 Article 24 provides for the exchange of certain information between the competent authorities of the two territories in compliance with international standards. The Article differs from the OECD Model in that it excludes VAT and customs duty from the scope of the Article, with these taxes and duties being covered by the Trade and Cooperation Agreement between the UK and EU.

Article 25 (Assistance in the collection of taxes)

5.40 Article 25 provides for the mutual assistance in the collection of tax debts between the United Kingdom and Portugal. The Article differs from the OECD Model in that it excludes VAT, customs duties and excise duties from the scope of the Article, with these taxes and duties being covered by the Trade and Cooperation Agreement between the UK and EU. This was not provided for in the 1969 Arrangements.

Article 26 (Members of diplomatic missions and consular posts)

5.41 Article 26 ensures that diplomatic or consular officials shall not receive less favourable treatment under the 2025 Arrangements than they are entitled to under international law or under the provisions of special agreements (such as the Vienna Convention on Diplomatic Relations). The Article follows the OECD Model.

Article 27 (Entitlement to benefits)

5.42 Article 27 is an anti-abuse rule. It includes "the principal purpose test" (PPT) which denies treaty benefits to a person who seeks to take advantage of the provisions of the 2025 Arrangements to secure a result which is contrary to their object and purpose. The PPT is one of the elements of the minimum standard on preventing treaty abuse agreed under Action 6 of the BEPS project.

Article 28 (Entry into force)

5.43 Article 28 contains the provisions governing how and when the 2025 Arrangements will enter into force and take effect.

Article 29 (Termination)

5.44 Article 29 contains the provisions that govern how the 2025 Arrangements can be terminated and how that termination has effect.

Article 30 (Registration)

5.45 Article 30 sets out the requirement for the territory in which the Convention is signed – the United Kingdom – to transmit it to the United Nations for registration following its entry into force, and to advise Portugal once this has been completed

Protocol

5.46 The Protocol contains clarificatory and additional material relating to the articles above, and forms an integral part of the 2025 Arrangements.

5.47 Paragraph 1 clarifies that, in respect of paragraph 2 of Article 13 (Capital gains), that "comparable interest" includes the holding of units in an undertaking for collective investment under Portuguese domestic law.

5.48 Paragraph 2 provides detailed rules for the operation of mandatory binding arbitration under the Mutual Agreement Procedure, as provided by Article 23. This is based largely on the OECD Model Competent Authority Agreement published to implement Part VI of the BEPS provisions in respect of tax treaty measures. It allows for taxpayers to request binding arbitration if the competent authorities have been unable to agree a solution under the Mutual Agreement Procedure after 3 years, and sets out how arbitrators are appointed, the method of arbitration, the timeline for arbitration, and various other administrative requirements.

5.49 Paragraph 3 provides a definition for "VAT", "customs duties" and "excise duties" in relation to their exclusion from Articles 24 (Exchange of Information) and 25 (Assistance in the collection of taxes).

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument brings into effect the provisions of the 2025 Arrangements.

Why was this approach taken to change the law?

6.2 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 The 2025 Arrangements were published on the gov.uk website on 17 October 2025 and a written ministerial statement to that effect was made on 27 October 2025. A consultation on the 2025 Arrangements was not undertaken as they were the product of bilateral negotiations with Portugal that dealt with a wide range of complex issues not suitable for open negotiation. However, HMRC regularly consults with external interested parties, including business representatives, about the United Kingdom's network of DTCs.

8. Applicable Guidance

8.1 General guidance on the operation of the United Kingdom's double taxation conventions can be found on the HMRC pages of the gov.uk website[1] and in the Double Taxation Relief Manual[2].

8.2 This Manual will be updated once the 2025 Arrangements enter into force, which will be after both the UK and Portugal have completed their ratification of the 2025 Arrangements.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note has not been prepared for this instrument because it gives effect to a DTC. DTCs do not introduce new tax burdens. Rather, they provide relief from tax. Taxpayers may have to make a claim to HMRC or the fiscal authority of Portugal in order to benefit from the Arrangements.

[1] Guidance on the operation of the UK's DTAs: https://www.gov.uk/hmrc-internal-manuals/international-manual/intm150000

[2] Double Taxation Relief Manual: https://www.gov.uk/hmrc-internal-manuals/double-taxation-relief

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because apart from one-off costs of familiarisation with the benefits of the DTC there are not expected to be further costs.

9.3 The legislation does impact small or micro businesses but, as with other businesses, the impact is negligible and no special approach for small or micro businesses is necessary.

9.4 There is no, or no significant, impact on the public sector because apart from one-off costs of introducing the DTC any further costs of administration would be minimal.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is that DTCs are kept under regular informal review through communication with affected taxpayer groups and other stakeholders, and this measure will be monitored as part of that process.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Double Taxation Relief and International Tax Enforcement (Portuguese Republic) Order 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").