THE EXECUTIVE REMUNERATION REVIEW

SEVENTH EDITION

Editors
Arthur Kohn and Janet Cooper

THE LAWREVIEWS

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EDITOR'S PREFACE

Executive remuneration encompasses a diverse range of practices and is consequently influenced by many different areas of the law, including tax, employment, securities and other aspects of corporate law. We have structured this book with the intention of providing readers with an overview of these areas of law as they relate to the field of executive remuneration. The intended readership of this book includes both in-house and outside counsel who are involved in either the structuring of employment and compensation arrangements, or more general corporate governance matters. We hope this book will be particularly useful in circumstances where a corporation is considering establishing a presence in a new jurisdiction and is seeking to understand the various rules and regulations that may govern executive employment (or the corporate governance rules relating thereto) with regard to newly hired (or transferring) executives in that jurisdiction.

The most fundamental considerations relating to executive remuneration are often tax-related. Executives will often request that compensation arrangements be structured in a manner that is most tax-efficient for them, and employers will frequently attempt to accommodate these requests. In order to do so, of course, it is critical that employers understand the tax rules that apply in a particular situation. To that end, this book attempts to highlight differences in taxation (both in terms of the taxes owed by employees, as well as the taxes owed – or tax deductions taken – by employers), which can be the result of:

a the nationality or residency status of the executives;
b the jurisdiction in which the executives render their services;
c the form in which executives are paid (e.g., cash, equity (whether vested or unvested) or equity-based awards);
d the time at which the executives are paid, particularly if they are not paid until after they have 'earned' the remuneration; and
e the mechanisms by which executives are paid (e.g., outright payment, through funding of trusts or other similar vehicles or through personal services corporations).

In addition to matters relating to the taxation of executive remuneration, employment law frequently plays a critical role in governing executives' employment relationships with their employers. There are a number of key employment law-related aspects that employers should consider in this context, including:

a the legal enforceability of restrictive covenants;
b the legal parameters relating to wrongful termination, constructive dismissal or other similar concepts affecting an employee's entitlement to severance on termination of employment;

c any special employment laws that apply in connection with a change in control or other type of corporate transaction (e.g., an executive's entitlement to severance or the mechanism by which an executive's employment may transfer to a corporate acquirer); and

d other labour-related laws (such as laws related to unions or works councils) that may affect the employment relationship in a particular jurisdiction.

The contours of these types of employment laws tend to be highly jurisdiction-specific and therefore it is particularly important that corporations have a good understanding of these issues before entering into any employment relationships with executives in any particular country.

Beyond tax and employment-related laws, there are a number of other legal considerations that corporations should take into account when structuring employment and executive remuneration arrangements. Frequently, these additional considerations will relate to the tax or employment law issues already mentioned, but it is important they are still borne in mind. For example, when equity compensation is used, many jurisdictions require that the equity awards be registered (or qualify for certain registration exemptions) under applicable securities laws. These rules tend to apply regardless of whether a company is publicly or privately held. In addition to registration requirements, it is critical for both employers and employees to understand any legal requirements that apply in respect of executives' holding, selling or buying equity in their employers.

Given the heightened focus in many jurisdictions on executive remuneration practices in recent decades – both in terms of public policy and public perception – the application of corporate governance principles to executive compensation decisions is crucial to many companies. Decisions about conforming to best practices in the field of executive remuneration may have substantial economic consequences for companies and their shareholders and executives. Corporate governance rules principally fall into two categories. The first concerns the approvals required for compensatory arrangements; a particular remuneration arrangement may require the approval of the company's board of directors (or a committee thereof). Many jurisdictions have adopted either mandatory or advisory 'say on pay' regimes, in which shareholders are asked for their view on executive remuneration. The second concerns the public disclosure requirements applicable to executive remuneration arrangements; companies should be aware of any disclosure requirements that may become applicable as a result of establishing a new business within a particular jurisdiction, and in fact may wish to structure new remuneration arrangements with these disclosure regimes in mind. In recent years, there has also been increased legislative and shareholder focus in many jurisdictions on environmental and social governance issues, such as the gender pay gap, tying executive compensation to environmental and social goals, and diversity initiatives.

We hope that readers find the following discussion of the various tax, statutory, regulatory and supervisory rules and authorities instructive.

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Cleary Gottlieb Steen & Hamilton LLP
New York
September 2018

Chapter 16

PORTUGAL

Bernardo Abreu Mota, Martim Morgado, Pedro Furtado Martins and Ricardo Cunha Leal[1]

I INTRODUCTION

With the exception of the financial sector, senior executive compensation is not subject to special rules or regulations under Portuguese law.

There is, therefore, a high degree of flexibility for parties to arrange remuneration schemes that better suit the interests of both companies and employees.

The way companies choose to structure and implement these remuneration schemes is influenced by a multiplicity of factors, namely (1) by the tax and social security regime, seeking the least costly solutions, for both employer and employee; (2) by the labour rules, that in Portugal are particularly restrictive, trying to adopt forms of remuneration that enable some degree of flexibility and the possibility of altering its value and structure; and (3) by management reasons, granting benefits designed to encourage productivity and increase loyalty and length of service. These benefits may be subject to the company's performance results (performance-related margin and bonus system, equity participation or stock options) or to the employee's performance (either individual or group performance evaluation) or they can be deferred benefits for the purpose of discouraging a change of job to a competing company (pension schemes, among others).

II TAXATION

i Income tax for employees

Tax residency is the key concept of Portuguese income taxation rules. An individual is deemed to be resident in Portugal if he or she spends over 183 days in Portuguese territory or if he or she has their main abode in this country. Therefore, strictly under domestic rules, if the individual's primary place of residence is in Portugal, that person will be considered a Portuguese resident even if he or she spends most of the year abroad.

Individuals that are classified as residents in Portugal for tax purposes are subject to Portuguese personal income tax on their worldwide income (i.e., irrespective of where their income is generated). On the other hand, non-residents are subject to tax only on the income that is deemed to be obtained in Portugal.

The tax is levied on specific categories of income, defined as Category A to Category H. In general, active income (including employment compensation) is taxable at progressive rates of up to 48 per cent (on income in excess of €80,000) whereas passive income (dividends,

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capital gains and interest) is taxable at a fixed rate of 28 per cent. An additional progressive surcharge is applicable at the following rates: 2.5 per cent on taxable income exceeding €80,000 and up to €250,000; and 5 per cent on taxable income exceeding €250,000.

Income earned by non-resident individuals is generally subject to withholding tax at the rate of 25 per cent. The payer is responsible for withholding the applicable tax.

Compensation for employment work (salaries) is included in Category A of taxable income. Fringe benefits and all other forms of compensation related to the employment relation are also generally subject to tax under Category A.

The attribution (for free or at a discounted value) of shares by the employer to the employee is taxable as employment income and there is no taxation until the shares are effectively acquired, either by a transfer for no consideration (or a discounted value) or by exercising the option to acquire the shares at the strike price. In both cases the difference between the consideration paid by the employee and the fair market value of the shares on the date of acquisition is characterised as employment income and is subject to tax according to the rules described above.

Any gains realised on a subsequent transfer of those securities or any dividends received are subject to withholding tax in Portugal at the rate of 28 per cent. This rate is final for both resident and non-resident individuals.

All deferred payments, according to Portuguese tax rules, should only be taxed upon effective attribution (i.e., only in the year they are paid or made available to the employee).

Pension fund contributions made by the employer are immediately taxable as employment income where such contributions are individualised and constitute acquired rights of the employee. By contrast, contributions made by the employer that are not individualised or do not constitute acquired rights of the employee are not taxable on the moment of the contribution, but rather on the moment the funds are paid to the beneficiary. In these cases, if the funds are paid by the pension fund before the retirement age, the income is also classed as employment income.

Lastly, it is also important to consider that there is a special tax regime for individuals that become residents in Portugal under the Non-Habitual Residents tax regime (NHR). This regime was designed to attract foreign individuals to Portugal and under this regime individuals will benefit from preferential rates as well as full exemptions in certain categories of income, as further explained below.

ii Social taxes for employees

In Portugal, there are no different rules concerning social taxes applicable to residents and non-residents.

Regular salary (excluding extraordinary bonuses) for work that is materially executed in Portugal is subject to social security contributions at the rate of 23.75 per cent for the employer and 11 per cent for the employee.

Employers with no establishment in Portugal who hire employees to work within Portuguese territory must register before the Portuguese Social Security and enter into a mandate contract appointing the employee as the company representative for social security purposes. Social contributions shall be paid by both parties, at the ordinary rates.

iii Tax deductibility for employers

Remuneration paid to the employees is generally deductible by the employer without exception and, to this effect, there is no difference on the basis of the level of or qualification of the employee. However, certain incurred expenses, such as extraordinary bonuses paid to members of the board, incurred or supported by entities subject to Corporate Income Tax are subject to a penalty taxation at the level of the company. The most noticeable example is the case of bonuses that are subject to such penalty tax at the rate of 35 per cent.

The form in which remuneration is paid does not affect the amount or the timing of deductibility.

iv Other special rules

No special rules apply to the taxation of compensation paid to employees in the context of an event of change of control.

The amounts received for employees for the termination of the employment contract are exempt up to the average of the regular salary subject to taxation of the last 12 months multiplied by the years of work. This exemption does not apply for termination payments to directors and board members.

On the other hand, for Social Security purposes, no liability to contributions arises in respect of the compensation for termination of employment contract, except in some cases of termination by agreement.

III TAX PLANNING AND OTHER CONSIDERATIONS

Individuals that transfer their tax residency to Portugal may apply for the NHR tax regime. This regime allows for rate reductions or exemptions on certain categories of income, as further explained below.

The NHR regime is applicable for a period of 10 consecutive years, from the year of the registration as a resident on Portuguese territory. Taxpayers that cease to be residents in any of those years may still apply the regime in any subsequent year that they return to Portugal, but always within the original 10-year period.

Under the NHR rules, foreign source employment income (including salary) is exempt from tax in Portugal to the extent it was effectively taxed in the source country (i.e., either in the country where the employment is effectively exercised or where the employer is resident for tax purposes).

If this income is not taxed abroad, then the foreign source compensation income is taxable under the same rules that apply for domestic sourced income.

In turn, domestic source employment compensation income is generally taxable at progressive rates (of up to 48 per cent on income in excess of €80,000), unless it relates to employment in a 'high value-added activity', which consists of activities that are specifically listed, in which case the income is taxable at the fixed rate of 20 per cent.

In any case, if the employer is a non-resident entity without a branch or any other form of permanent establishment in Portugal, this income, even if taxable, will not be subject to withholding tax in this country.

IV EMPLOYMENT LAW

i General remarks

Portuguese employment law is applicable to all employees regardless of their qualification or position in the employer's organisation. Hence, executives' and senior executives' employment contracts are subject to the same worker protection rules and regulations as other employees, although there are some exceptions, most of them related to working time limitations. One important exception is the possibility of hiring senior executives, whose jobs presume a special trustworthiness, under the regime of service commission. This type of employment contract may be used for admission of new personnel or be applicable to pre-existing employees. The general rules on termination are not applicable here (see Section IV.iii).

The Portuguese Labour Code (LC) has several rules about remuneration that should be taken into consideration when designing compensation and benefits schemes. The most relevant is the prohibition to reduce pay, even with the employee's consent, except where expressly provided for by law (such as the adoption of exceptional measures for companies in economic difficulties) or by collective agreement. However, this prohibition does not affect the grant of variable payments or bonuses related to the employee's or the company's performance, provided that certain conditions are observed. It is also possible to remove pay supplements directly dependent on the terms and conditions under which the work is rendered, provided there is a clear connection between the payment in question and the work conditions that justify that payment.

In the majority of cases, remuneration is agreed on a monthly basis, but for senior executives it is becoming more frequent to establish an annual amount. Because the LC establishes that all employees are entitled to holiday and Christmas allowances, when remuneration is agreed on an annual basis it should be clear that this amount already includes the above-mentioned allowances.

Long-term incentive plans (such as the grant of bonuses related to the company's performance or stock options) are not regulated by employment law and can be subjected to specific conditions in order to avoid that the benefits emerging from these plans have retributive nature and are therefore subject to the guarantee provisions regarding retribution.

ii Restrictive and non-solicitation covenants

As a general rule, the employee's right and freedom to work render null and void any restrictive covenants after the employment's termination. There are, however, exceptions, and non-compete agreements are allowed provided that the four following requirements are simultaneously met:

a the covenant is put down in writing, under the employment contract or under the termination agreement. It can also be included in any other document, such as share acquisition agreements, which are subject to the same rules if the selling shareholder is an employee;

b the performance of a competing activity is likely to cause harm to the employer;

c the non-compete clause may be applicable for a maximum of two years after termination of the contract or up to three years if the activity performed entails a special relationship of trust or access to sensitive information; and

d the employee is granted compensation for the period in which his or her activity is restricted.

There is no legal rule establishing the amount that should be paid to the employee for the period of the non-compete clause. However, in the event of an unlawful dismissal or termination on specific grounds by the employee, the above-mentioned compensation shall at least correspond to the amount of the monthly basic salary paid to the employee at the time of his or her termination. Otherwise the non-compete clause cannot be invoked. The employer can, nonetheless, subtract from the compensation the income eventually earned by the employee following the termination of the contract.

If the employee fails to comply with the non-competition clause, the employer may request him or her to reimburse the compensation paid as well as seek compensation in excess of that amount if the damage suffered by the employer is higher.

Exclusivity clauses, under which the employee is prevented from pursuing any other professional activities during his or her employment contract, are not subject to specific legal provisions and are commonly used for executives.

Non-solicitation covenants of customers or clients are only allowed if they result from a non-competition covenant that fulfils the above-mentioned requirements.

Finally, any agreement settled between employers in order not to hire each other's employees will be null and void.

iii Termination of employment

Termination of open-ended employment contracts cannot be made by the employer outside a 'just cause' scenario. This concept includes both disciplinary dismissals and dismissals based on objective grounds, as expressly provided for under the LC.

The LC foresees the following types of dismissal: dismissal based on unlawful conduct of the employee (or disciplinary dismissal); redundancies or dismissals resulting from the elimination of jobs (collective dismissals and individual redundancy); and dismissal for failure to adapt (which is not used in practice).

The dismissal may only occur after following a complex procedure that takes several weeks to be completed. If the proper procedure is not observed, the dismissal is considered unlawful even if there were reasons to terminate the employment contract.

In case of disciplinary dismissal, the employer does not have to pay compensation for the termination of the employment contract nor provide for a notice period, although the dismissal procedure must always be completed.

In case of redundancies (collective dismissal or individual redundancy) the final decision has to be issued observing a prior notice period of 15, 30, 60 or 75 days, depending on the employee's seniority. In the event of a collective dismissal or individual redundancy, employees are entitled to a compensation. The rules about compensation were updated in 2011, 2012 and 2013. For contracts entered into force after 1 October 2013, the compensation corresponds to 12 days of basic pay and seniority allowances per year of employment, capped at 12 times the basic monthly salary or 240 times the minimum wage (currently €139,200).

Ordinary employment contracts are not allowed to establish different rules on termination (whether more or less favourable to employees). Therefore, it is not possible to agree in advance (in the original employment contract or in another complementary agreement) on the value of the compensation to be paid if case of termination (the 'golden parachute' clauses). This, however, does not make it invalid for the parties to enter into a termination agreement and to agree on the compensation amount under that agreement.

The dismissed employees may file a claim before a labour court in order to challenge the termination of their labour contracts.

If the court decides that there was any illegal procedure or lack of reasons or formalities on the dismissal, the employees may choose between being reinstated in the company, or receive a compensation ranging between 15 and 45 days of base remuneration plus seniority bonus per year or fraction of year of seniority, with a minimum of three months of base remuneration plus seniority bonus.

On both situations, the employees shall be entitled to the salaries that they would have received if the dismissal had not taken place and to an eventual compensation for damages suffered.

If the employer is a company that has nine employees or fewer, or if the employees dismissed are managers or senior executives, the employer can oppose reinstatement. This is provided that the employer can show that the employee's return would seriously interfere with and prejudice the company's ordinary activities. The court must assess the employer's arguments. In this particular case, the employee will be entitled to a compensatory award equivalent to between 30 and 60 days of basic pay and seniority payments for each full year or fraction of a year's service, subject to a minimum of six months of base remuneration plus seniority bonus.

The general rules on termination are not applicable to executives who have been hired through the special regime of 'employment contract in commission'. In this case, termination by the employer does not need to be justified nor is it necessary to follow a specific procedure. Both parties may terminate the employment relationship at will, by giving a prior notice of 30 days or 60 days to the other party, depending on whether the contract lasted up to two years, or more than two years. Termination by employer initiative gives the employee the right to a compensation corresponding to 12 days of basic pay and seniority allowances for each year of employment. The notice period and the compensation amount may be increased under the employment contract in commission (this not being possible under ordinary employment contracts).

The reasons that may lead to a unilateral termination of the contract by the employee with just cause are expressly stipulated by law. Those reasons may be related, among others, to an unlawful behaviour by the employer (constructive termination) or to objective reasons (such as the lawful modification of employment conditions). If it becomes immediately impossible to continue the employment relationship in ways to be considered as just cause, an employee may terminate it immediately, without prior notice. In this event, the employee is entitled to compensation to be determined between 15 and 45 days of base pay and seniority pay for each year worked, depending on the amount of compensation and the extent of the employer's unlawful conduct, and may not be less than three months of base pay and seniority pay. Change of control as such is not a valid cause for termination, neither for the employer nor for the employee. The employment contract remains into force with the same terms and conditions previously agreed. Even for senior executives that may have a special relationship with the previous owner, the change of control is not cause for termination, as the employer remains the same – the company – despite the changes in its ownership structure.

Under Portuguese law (which broadly speaking is a transposition of the regulations contained in EU Directive 2001/23/EC, of 12 March) the transfer of an undertaking does not constitute cause for termination by the employer. Employment contracts will be automatically transferred to the transferee in the exact terms and conditions into force at the moment the transfer occurs. However, the employee's right to oppose the transfer of his or her employment contract to the transferee is now (since March 2018) expressly included in the Portuguese employment law. The employee is entitled to oppose the transfer of his or her employment contract whenever a transfer may cause him or her serious loss, namely by the transferee's evident insolvency or difficult financial situation or, also, if the employee does not trust transferee's policies regarding work organisation. The above-mentioned grounds are so broad and subjective that one can question if the employee is truly obligated to justify his or her opposition. As an alternative, the employee is entitled to terminate his or her employment contract, this termination being considered a unilateral termination with just cause. The employee will therefore be entitled to a monetary compensation calculated in accordance with the rules applicable to a collective dismissal.

V SECURITIES LAW

According to Portuguese securities law, a share plan has regulatory implications solely if it can be qualified as a public offer.

An offer is deemed to be public in the following circumstances:

a if the offer of securities is addressed, wholly or partially, to unidentified recipients;

b if the offer is addressed to all the shareholders of a public company;

c if the offer is, wholly or partially, preceded or accompanied by a prospecting or a solicitation for investment's intentions from unidentified addressees or promotional material; and

d if the offer is addressed to at least 100 persons who are non-qualified investors resident or established in Portugal.

The application of these criteria to share plans is not always straightforward, the key question lying on the qualification of the plan as an offer of securities. For example, 'phantom' stock purchase plans, in principle, should not be qualified as offer of securities, as they do not involve effective acquisition of securities.

If the share purchase plan involves a public offer, a filing will be required with the Portuguese Securities Market Commission (CMVM) and the need to approve a prospectus. Acceptances of the offer have to be transmitted through an authorised financial intermediary.

An important exemption of the prospectus requirement is granted for public offers of securities to existing or former directors or employees by their employer that has securities already admitted to trading on a regulated market or by an affiliated undertaking, provided that a document is made available containing information on the number and nature of the securities and the reasons for and details of the offer.

Otherwise, registration with CMVM is not required in connection with the offering of securities to current or former members of the management or workers' bodies by their respective employer, company in a controlling or group relationship with the latter or by a company subject to common ownership, provided that the issuer has its statutory or effective place of business in the European Union and a document providing information on the number and nature of the securities as well as the reasons and characteristics of the offer is available.

Directors of an issuer of securities admitted to trading on a regulated market (or of a controlling company), as well as related persons, shall notify the CMVM, within five working days, of all transactions carried out on their own account, on account of third parties or on their behalf, involving shares of said issuer or related financial instruments, where the value of such transactions reaches €5,000.

In addition to the general rules of information on inside information, issuers and persons acting on their behalf or account have to draw up insiders lists (e.g., lists of persons with access to privileged information), with the law providing for a set of specific duties associated with this obligation (comprising an obligation to include on the list, *inter alia*, the person's identity, the reasons for their inclusion and the date of inclusion; to keep the list strictly up to date; to inform the relevant person of his or her inclusion on the list and the legal consequences in case of disclosure or misuse of inside information; to keep the list for a period of five years; and to immediately forward the updated list to the CMVM whenever it so requests).

VI DISCLOSURE

Disclosure of information on remuneration of members of corporate bodies of public companies is subject to statutory law and regulations approved by the CMVM, requiring disclosure of remuneration policies approved on an annual basis to be included in the respective accounts and the corporate governance annual report if applicable.

Disclosure should cover individual and aggregate remuneration of directors and members of the audit body – referring the components giving rise to the variable remuneration – as well as the parts of the remuneration already paid and those payable in the future.

Public companies shall be entitled to adopt a corporate governance code different from regulations approved by the CMVM, provided, however, that the same applies equivalent disclosure rules and principles.

Disclosure requirements embody the principle of 'comply or explain' pursuant to which justification should be provided in relation to each of the requirements not complied with by the relevant company.

Presently there is a statutory principle of 'say on pay' by the shareholders, who are called to review the statement of remuneration policy of members of the corporate bodies.

VII CORPORATE GOVERNANCE

As a general statutory rule, approval of remuneration of members of the corporate bodies of a company is entrusted to the general meeting or to a corporate remuneration committee designated for the purpose (and enjoying of independence from the management bodies).

Certain adjustments to this principle may exist depending on the corporate governance structure adopted (for instance, in dual public companies inspired by the German model, competence is transferred from the general meeting to the supervisory board).

The Companies Code allows the remuneration of executive directors to partially consist of a percentage (the maximum amount of which needs to be set out in the articles of association) of the company's profits, whereas remuneration of directors with supervisory functions (i.e., members of the audit committee) must mandatorily consist only of a fixed sum (this solution is often recommended for all non-executive directors).

Public companies are subject to enhanced corporate governance requirements on approval of remuneration for members of the corporate bodies, in particular directors and executives. The latter remuneration should be structured in a way to allow alignment with the interests of stakeholders, be based on performance valuation and not incentivise excessive risk assumption.

In this context there are various recommendations in relation to performance evaluation criteria, growth of company and value obtained to shareholders, adoption of a variable remuneration component payable on a deferred basis, remuneration caps, etc. Clawback and recoupment provisions may be considered particularly in the context of executive directors' agreements, although no express requirement existing on the matter (but without prejudice in any event of statutory provisions on directors liability with regard to the company).

VIII SPECIALISED REGULATORY REGIMES

Portugal has implemented the EU regulations and the European Banking Authority orientations on remuneration on the financial sector, which cover remuneration of the members of the board and also staff members whose professional activities have material impact on the institutions' risk profile. In these cases, it is necessary to implement specific remuneration policies that must follow certain guidelines and are subject to some restrictions, in particular regarding variable remuneration (see EU Overview chapter).

There are also specific rules on remuneration of directors and management board members of companies owned or controlled by the government, although executives under employment contracts are not covered by those rules.

The special measures that, over the financial crisis period (2011–2015), imposed a salary reduction and freeze on career progression for civil servants and employees of companies owned or controlled by the Portuguese state were eliminated in 2017–2018.

IX DEVELOPMENTS AND CONCLUSIONS

The tax regime and its constraints are likely to continue their influential role on how remuneration schemes are designed, particularly with regard to executives. Considering the high tax burden in Portugal, any change in income taxes of both individuals and companies will certainly influence how remuneration schemes are organised. However, at the moment, there are no relevant reforms announced in this field.

The increasing pay gap between executives and workers in general, especially in large companies, has been making the headlines for the past few months. In view of that, one of the political parties that support the present government has announced their intention to propose legislation that would penalise the companies, either public or private, when the above-mentioned pay wage exceeds a certain limit. However, so far, those measures have not been proposed and it is not expected that such legislation will ever see the light of day.

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