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Tax regime for Portuguese law firms 'could change in a year'

Change of leadership at Portuguese Bar Association as well as new government tax secretary raises hopes that law firms could soon pay less tax and therefore invest more in technology and other infrastructure

There are high hopes among lawyers in Portugal that there could be an imminent change to the country's tax law – perhaps within a year – that would mean law firms would be subject to the general tax regime, which would enable them to be taxed like a corporation and therefore build up reserves to invest in their infrastructure.

Under the current regime for Portuguese law firms, law firms are required to distribute all of their profits each year. When a law firm makes a profit,

João Afonso Fialho, Vieira de Almeida

each of the firm's partners must pay individual income tax on the profit, which including surcharges, can be as high as 53 per cent. However, Portuguese law firms have long wanted to be taxed on a corporate basis, which means that, not only would they not have to distribute all of their profits each year, but they would be subject to a tax rate of 21 per cent. To make matters worse for Portuguese firms, the tax regime applicable to them is not applied to the Portuguese offices of foreign law firms.

"Portuguese law firms are forced to pay taxes in advance – this is a problem of the tax regime – whereas Portuguese branches of foreign firms are subject to a different tax regime," says João Afonso Fialho, president of the Portuguese law firm association ASAP (Associação das Sociedades de Advogados de Portugal). "They [Portuguese firms] are required to distribute all the profits of the law firm, which is unfair in terms of competition – Portuguese law firms want a completely free market to level the playing field."

Afonso Fialho argues that the chances of the law changing – possibly within one year – have improved and are now looking good. Consequently, it is hoped Portuguese law firms will be given the option of being taxed under the present regime or being taxed under the general tax regime like a corporation. "There is a good prospect of [a change in the law] happening: the new chairman of the Portuguese Bar Association, Guilherme Figueiredo, supports the change, so the legal profession may be in a better position to influence the government," he says. Afonso Fialho believes the cause could be helped by the fact that the new Secretary of State of Tax Affairs, Fernando Rocha Andrade, is not a lawyer, so he could not be accused of acting out of self-interest. Afonso Fialho says that if the law was changed, it could give firms a "better capacity to invest, so they would become more professional from an organisational point of view".

According to Miguel Reis, partner at PLMJ, the tax framework for law firms is unfair because they must pay irrespective of whether they pay dividends, unlike companies in other sectors. "Lawyers should be treated as independent professionals, like architects or auditors, who avoid the transparency regime," he says. "Law firms would be able to make more investments with undistributed funds and would be placed in an equivalent position with other professions," he adds.

Supporters of a change in the tax regime say it would enable law firms to have non-lawyers as partners, which could be another way of making them much more competitive. For example, some lawyers argue that a firm having an experienced finance professional as a partner could potentially be more beneficial than having a first-rate lawyer.

However some lawyers doubt whether changing the tax regime will be enough to make law firms more competitive. Reis says: "We perceive that professional management and investment in information technology and knowledge management can play a much more important role than a change to the tax law."

Creating reserves

Pedro Pais de Almeida, partner at Abreu Advogados, says the current tax rules constitute "discrimination against Portuguese law firms in comparison with EU law firms operating in Portugal". He continues: "A change in the tax regime would contribute to the reinforcement of firms' financial stability, by allowing them to create reserves without the pressure of being obliged to distribute every cent."

João Marques Pinto, a partner at pbbr, argues that Portuguese law firms are not necessarily disadvantaged in the tax system. "As the profit of a law firm is calculated on an invoicing system, partners [if taxed like a corporation] could be subject to taxation on income that was never obtained by the law firm, due to non-payment, or late payment of invoices, for example." However, he acknowledges the advantage of a law change would be a lowering of partners' taxable income, allowing profits to be invested in infrastructure, equipment and personnel.