

# NEWS

## TAX

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Following the legislative authorisation granted by the 2007 Budget Law, the Ministers Council approved last December 27, 2007 the Decree Law that establishes the communication, information and clarification duties towards the tax authorities to prevent and combat so called abusive tax planning.

It is worth noting that the text of the approved Decree Law has not introduced significant changes to that of the previous project Decree Law (commented on by us in the November issue of our Tax Newsletter). However, the wording now adopted seems to clarify that the counselling regarding tax planning by a lawyer, solicitor or their firms, within the context of the evaluation of the client's legal situation, the scope of the legal counselling, in the defence or representation of the client in a judicial process or in respect of a judicial process, including advice regarding the way to start or avoid a process, shall not be considered an act of instigation. The same shall apply to recommendations made by a statutory auditor or their firms about tax planning or any act within the scope and for the purposes of the respective public interest performances. Besides these aspects, it is also important to that the legislator has now introduced a preamble and a justification note to the Decree Law which may be useful in helping better understand the real intentions of the Government on this subject.

As we have mentioned before, this Decree Law seems to have certain unconstitutional elements which, in our opinion, have not been removed from the text now approved by the Ministers Council. We will have to wait for the President of the Republic's decision to see whether he will ask the Constitutional Court for the preventive

## COMBATING TAX EVASION Abusive Tax Planning (II)

*Tiago Marreiros Moreira*

inspection of the Decree Law or if he will exercise his political veto or, possibly, if the President shall opt to promulgate the Decree Law without further delay.

According to the Government, the aim of this Decree Law is to reinforce efficiency in the combat of tax fraud and tax evasion, adopting preventive measures allowing a faster and more effective performance from the tax authorities, imposing upon the promoters that advise, propose or sell tax planning schemes or acts specific communication, information and clarification duties towards the tax authorities regarding any transactions having the obtaining of tax advantages as their exclusive or main goal.

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If this Decree is indeed promulgated, the above mentioned promoters (in general, any entity with or without legal personality, resident or established in any part of Portuguese territory, with some exceptions) that within the scope of their economic activity provide support, advice, counselling or any analogous service in the tax domain, regarding the determination of the tax status or the compliance of client's or third entities tax obligations, shall have to communicate to the General Directorate of Taxes (or *Direcção-Geral dos Impostos* - DGI) the tax schemes or acts proposed to clients or other entities, describing, indicating and characterizing the negotiation types, the company's structures and the operations or transactions proposed or carried out, as well as the type and configuration of the tax advantage that is sought and its legal basis.

It is also important to stress that, in spite of the communication duty, not including any

nominative or identifying indication of the clients or other entities regarding which the tax planning scheme was proposed or who have adopted it, when such an obligation does not fall on the promoter (namely when the scheme was proposed or accompanied by an entity who is not qualified as a promoter or who is a non resident promoter), therefore being users, those that have to comply with said duty, the identification of the client or entity will inevitably occur...

Despite the fact that the approved text somewhat reduces the amount of information to be provided to the tax authorities when compared to the project Decree Law, the high values of the penalties applicable to non compliance of such duties has remained unchanged. This may raise several difficulties in its application in real cases, as the penalties may vary between € 1.000 and € 50.000 or € 5.000 and € 100.000 for the lack of communication or late communication,

depending whether the entity obliged to said duty is an individual or a company and between € 250 and € 40.000 or € 500 and € 80.000 for the lack of communication or late communication by the client benefiting from the tax planning, depending whether the client is an individual or a company.

In view of the lack of clarity in the definition of this Decree Law's object and scope, as well as the numerous doubts that will be raised on its concrete application and also considering the high amounts of the applicable penalties, if this Decree Law is in fact promulgated by the President of the Republic, a careful and case by case analysis of the situations that may be subject to these communication duties will be highly advisable to ensure that the above duties were duly complied with. Last but not least, it is also worth mentioning that the date foreseen for the entry into force of this Decree Law has been changed from January 1, 2008 to May 15, 2008.

## BUSINESS ANGELS

### Investors falling from the sky

Ricardo Seabra Moura

Decree-Law 375/2007, from 8 November, has introduced into the Portuguese legislation the venture capital individual investor figure or "business angel". The concept of "business angel" was created by a group of private investors who have decided to fund Broadway productions at their own risk regardless of the huge economic recession at the time. Nowadays, these investors use their know-how, networking and economic capacity on those emerging businesses with a moderate/elevated economic risk. In Portugal, "business angels" must have the legal form of a single-person company in order to allow the division between the company's assets which assure the venture investment from the personal assets. This "business angel's" regime

only applies to individuals.

Within its primary goal, "business angels" may (i) invest in own capital instruments or in capital from associate-companies or in future associate-companies; (ii) provide guarantees to associate-companies or, in ancillary terms, (iii) provide management, financial, administrative or commercial assistance services to associate-companies, including those intended to grant credit to such companies.

In order to stimulate "business angels" investments in Portugal, the Portuguese State Budget for 2008 has provided some tax benefits:

a) Capital gains exemption applicable on shares held by business angels

**In order to stimulate "business angels" investments in Portugal, the Portuguese State Budget for 2008 has provided some tax benefits**

- for no less than one year;
- b) Possibility of avoiding the double taxation regarding distributed profits related to share capital held for no less than one year;
- c) Deduction on the tax assessed, up to its full amount, limited to the sum of the CIT collection of the last five years, as long as it refers to investment in companies with potential growth.

# SWAPS

## The announced end to swaps by way of the Budget Law to 2008?

Joaquim Pedro Lampreia

In light of its importance and the discreet way in which the norm that has changed the tax framework of some financial derivative products was introduced, we consider it essential to bring this under the spotlight it deserves, at the same time making sure that its nefarious consequences are adequately recognised.

The “it” being referred to in this case is the new paragraph 10 of article 5 of the IRS Code, introduced by article 42 of Law no. 67-A/2007, of 31 December (“Budget Law to 2008”), that came into force on the 1<sup>st</sup> of January.

This norm assimilates gains deriving from interest rate swaps, foreign exchange swaps, cross-currency interest rate swaps and also those from forward exchange transactions to “interests”.

Discreetly introduced into the IRS Code, this legislative amendment did not seem, at first glance, likely to cause great impact. The truth, however, is otherwise.

To fully understand the dimension of the disaster, it is necessary to bear in mind that the above mentioned swaps and forwards are financial instruments designed to hedge the risk of interest rate and exchange rate volatility. They are, therefore, essential to the internationalization of any economy (with a special relevance to the export sector, services and the financial sector). It is in this light that many entities with tax residence in Portugal negotiate – as a good management policy – these financial instruments with national and international financial entities.

In order to avoid the application of withholding tax to payments made to the non-resident institutions under these transactions, resident entities use – with every legitimacy – the

Treaties to Avoid Double Taxation (“ADTs”), signed between Portugal and the State in which the other entity has its residence, which eliminated the need for such withholding tax. The true effect of the legislative amendment is precisely to avoid the usage of such ADTs as a means of doing away with the mentioned withholding tax.

It is essential to note that the ADTs foresee the application of a withholding tax (at reduced rates of between 10% and 15%) if the gains are qualified as “interest”. This is important since the definition of “interest” included in the majority of ADTs entered into by Portugal makes a *reference to the internal law*, that is, it qualifies as “interest” the income that is qualified as such by the internal law of the payer State. Therefore, in assimilating gains deriving from the above mentioned financial instruments to “interests”, the new paragraph 10 of article 5 of the IRS Code has the effect of also qualifying such gains as “interest” for purposes of the ADTs in question. As a consequence, the majority of ADTs will cease to allow gains deriving from swaps to be paid without withholding tax after January 1<sup>st</sup> 2008.

In light of the above, albeit in a furtive way, this legislative amendment prevents the usage of the majority of ADTs to eliminate withholding tax. The legislator’s intention was to maximize tax revenue. Was this reasonable? The answer surely has to be “no”.

Apparently, the legislator did not take into account that fact that imposing a withholding tax on swap and forward transactions may make such transactions all but unviable in practice. Such inviability arises from the “workframe” of these types of instruments (which function under generally small margins) rather than from the economic consequences of the withholding.

**The majority of ADTs will cease to allow gains deriving from swaps to be paid without withholding tax after January 1<sup>st</sup> 2008**

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Furthermore, the amount of tax revenue obtained will be tiny, as the withholding tax will only apply to the differential between the cross payments and since the applicable withholding will be applied at a reduced rate (as mentioned above). It should be underlined that, regarding the operation already in force, it will be the Portuguese resident entities that will bear this tax, since the vast majority of agreements include a gross-up clause.

It should also be noted that, from a conceptual point of view, the assimilation to interest now introduced into the law does not make any sense, as the Tax Authorities have themselves stated (i.e., Administrative Order no 1024/2004-XV of SEAF of 27.04.2004) and goes against the expressed opinion of the OECD and the practice followed by developed countries.

One should argue that the legislator did not account for the dire economic consequences that this amendment will cause, sacrificing – as it does – the economic realm to that of tax revenues. This is even more absurd when what is at stake is an insignificant amount of tax revenue.

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29 November

## Beneficiaries of donations obliged to maintain a record of amounts received

From 1 January 2008 beneficiaries of donations will be obliged to keep an up-to-date record of their donors, including name, taxpayer number, date and amount of donation under the Scientific Patronage Regime. Beneficiaries will issue a document specifying the amount and legal rules under the Scientific Patronage Regime applicable to the donations, stating that it is received without any kind of compensation.

6 December

## New tax registry regulation

A single Decree-Law will from now on provide rules related to taxpayer identification, namely the attribution and management of this information, which was until now put forward in several legal acts. The new Decree-Law, still pending Government approval, will also set out the rules regarding taxpayer identity card issuance and the introduction of proceedings to simplify tax compliance.

7 December

## Excise Duty on Petroleum and energy products

Ministerial Order no. 1554-A/2007 recently came into force, providing the authorization procedures referring to excise duty on petroleum and energy products for economic entities that implement the use of bio fuel into consumption, also providing the conditions regarding supply compliance and default consequences.

11 December

## Government approves new Public Individual Savings Account regime

The Labour and Social Security Ministry presented a new regime which allows each worker to make an additional contribution to a Public Fund through retirement certificates that are represented by participation units in a voluntary and stable subscription fund. This is aimed at all those taxpayers included in a social protection regime. The fund's subscription will be renewable annually, with the possibility of suspending contributions or modifying the rate thereof. Putting the accumulated capital to use will only be possible on age-related or incapacity-related retirement.

Note that these contributions are subject to a tax benefit: 20% of the amount of the contribution is deductible on PIT (with a limit of € 350 per taxpayer).

12 December

## European Commission recommends better application of anti-avoidance rules

By means of a recommendation sent to the Member States, the European Union has invited a review of their application of anti-avoidance rules regarding direct taxes, this due to the eventual need of amendments in order to respect recent European Court of Justice's judgments. This recommendation relies on the fact that present rules are not completely compatible with European liberties.

## Tax assessment protocols

Tax authorities are analyzing the possibility of entitling private entities to assess taxpayers' debts on behalf of the Portuguese State. Protocol agreements are foreseen between central administration and local administration entities, as well as credit institutions. This is an initiative within the Central Administration Restructure Programme, aiming at the development of alternative assessment solutions.

15 December

## European Taxation Systems

Programme Fiscalis 2013 was created and published in a recent European Parliament and Council co-decision. This programme aims to improve taxation systems within the common market and will be in force between January 2008 and December 2013. The main goals are (i) an efficient and broader exchange of tax information, (ii) a coordinated control of taxpayers' obligations and (iii) better understanding of European Community Law in order to promote a more appropriate application of the current tax regimes.

27 December

## Abusive Tax Planning – The Disclosure Regime

The new abusive tax planning disclosure regime was approved by Government in the last Council of Ministers. This Decree-Law is now less restrictive than the previous draft-regime, namely because the disclosure obligations are now reduced to those where (i) a non-resident from a tax haven is involved, or from an area subject to a lower taxation or even a zero taxation territory, or the beneficiary is total or partially exempted, (ii) finance or insurance transactions occur, determining the income re-qualification or the beneficiary modification, (iii) tax loss is used, or finally, (iv) the tax planning scheme is presented with a confidentiality clause or an exclusion/limited liability clause protecting the promoter.

**Tax Calendar - January 2008**

Day	Tax	Obligation
10	VAT	Monthly VAT returns - submission of October 2007 VAT return (and its annexes) and payment of the tax due
15	Social Security	Payment of the previous month's contributions
21	PIT/CIT	Payment of the tax withheld in the previous month
	CIT	Delivery of document evidencing interest, life insurance premiums and other costs payment paid by credit institutions and insurance companies to taxpayers, regarding 2007 payments deductible from taxable income
		Delivery of evidence documentation regarding tax withheld in 2007 by payers obliged to withhold
	Stamp Duty	Payment of the tax assessed for transactions performed in previous month
31	VAT	Delivery of Modification Declaration to retail traders under article 60 of the VAT Code regime which have exceeded the provided limits
		Delivery of the Modification Declaration by taxpayers under article 53 VAT Code exemption regime which have exceeded the provided limits

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