

Taxation of bonuses and Portugal's Constitutional Court

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In the wake of the financial crisis of 2007-2008, the Portuguese Government introduced a corporate tax of 50 percent over expenses on bonuses paid by credit and financial institutions and of 35 percent regarding bonuses paid by other corporate entities to their Board of Directors members.

Both taxes were introduced by the 2010 State Budget Law which, due to the legislature's schedule, only entered into force April 29th, 2010. This late entry raised many doubts as to whether such taxes could be applied to bonuses paid or assessed between January 1st, 2010 and April 29th of that year. The concern was that such application would amount to a retroactive taxation, which is not allowed by the Portuguese Constitution.

However, on January 12th, 2011, the Constitutional Court swiftly brushed aside all unconstitutionality arguments that were raised against a 2008 Law, which increased the autonomous taxation on certain car expenses. This Law entered into force in December but expressly stated that it applied to all expenses incurred during 2008.

The Constitutional Court's decision is straightforward: since the autonomous taxation on car expenses is formally included within the general Corporate Income Tax, and since the taxable fact for this tax only occurs at year-end, a raise in the taxation rate in December is not retroactive when applied to events occurred in that same year.

What this decision (which had four votes in favor and one vote against) failed to address was the fact that the rise in taxation was not on income (regarding which there is no doubt that the taxable fact is only completed at year-end), but on certain expenses, which are by definition completed whenever an expense occurs. As the judge that voted against the majority brilliantly stated, this difference warranted the opposite outcome: the raise in taxation over expenses that has already occurred should have been declared unconstitutional.

The similarities between the taxation on car expenses and the taxation bonuses are easy to spot, being both taxes on corporate expenses and being both inserted into the Corporate Income Tax regime.

Does this spell the end for the unconstitutionality defence against taxes on bonus applied before their entry into force? Not yet, for there are seven more Constitutional Court judges that have not yet expressed a view on the matter (several of which have taken a very severe stance against retroactive taxation in the past). Also, the Supreme Administrative Court is yet to decide on the matter. And although this Court does not have the final word on constitutional matters, it is the Court which is, historically speaking, more technically prepared to deal with these issues, and its reasoning as regards this case is now much anticipated.

It is therefore our opinion that this controversial and poorly reasoned decision by the Constitutional

Court does not settle the matter for bonus taxation. But it sends a signal that there is more leniency towards retroactive taxation than once thought.

Joaquim Pedro Lampreia is a Managing Associate in the Tax team at Vieira de Almeida in Lisbon. He can be reached via viajpl@vda.pt

Ricardo Seabra Moura is a Senior Associate in the Tax team at Vieira de Almeida. He can be reached via rsm@vda.pt