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Portugal

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After last year, 2010 has been, yet again, an eventful year in the tax domain in Portugal as the government focused on deficit reduction and budget consolidation measures, explain Tiago Marreiros Moreira and Conceição Gamito of Vieira de Almeida & Associados

A lively year for tax in Portugal in 2009 was marked by the amendment of the corporate income tax rules in line with the new accounting system, the narrowing of bank secrecy, the taxation of severance compensations to directors, managers and board directors (golden parachutes taxation), the approval of the new Social Security Contributions' Code (although its entry into force was postponed) and the enactment of the new Tax Investment Code, together with a new tax regime for non-habitual residents (impatriates tax regime).

2010 State Budget tax amendments

The State Budget for 2010 was published in late April as the present government took office only in late October 2009. It pointed to three priorities for the tax system: the strengthening of tax fairness and relaunch of the economy, the intensification of environmental taxation and the rebalance of the relationship between tax authorities and taxpayers. Deliberately thin with tax changes, State Budget 2010 puts into practice those priority areas through the implementation of selective measures, with a view to instilling confidence in the economy.

In the area of tax fairness and economic relaunch, these measures are worth mentioning:

- Simplification of final withholding rates, which approved a uniform rate of 20% for a variety of income that was previously subject to rates ranging from 15% to 35%, with a significant impact on income derived by non-resident taxpayers from the provision of certain services in Portugal when there are no tax treaties with their country of residence (previously subject to a 15% final withholding tax rate);

- A corporate income tax (CIT) autonomous rate of 35% applicable to bonuses and other variable remuneration paid to directors, managers and board directors, where they represent more than 25% of the annual remuneration and are more than €27,500 ($35,400), unless not less than 50% of the respective payment is deferred for a three-year period and subject to a positive performance during this period;

- A CIT autonomous rate of 50% applicable to bonuses and other variable remuneration paid or determined in 2010 to managers and board directors of financial institutions, when they represent more than 25% of the annual remuneration and are more than €27,500;

- Reduction of the tax losses carry-forward period from six years to four years;

- Extension of the payment in instalments period for up to 10 years for companies in recovery process (that is, a maximum of 120 instalments, where previously the maximum was 60);

- Extension of the scheme for value added tax (VAT) recovery in bad debts under an extra-judicial conciliation procedure;

- Accumulation of the tax benefit for net employment creation with other tax and social security incentives for employment creation, for the same employee or job;

- Deduction, by qualified venture capital investors (business angels), of 20% of the investment amount against CIT due, up to a maximum of 15%, if this investment complies with certain requirements;

- Increase to 70%, with a ceiling of €1.8 million (previously 50% and €1.5 million), of the CIT credit for expenses connected to the hiring of people with doctorates (PhDs);

- Extension of the Tax Scheme for Investment Support to the fiscal year 2010, allowing taxpayers making qualified investments in this year to benefit from a number of CIT, municipal property tax and stamp tax incentives;

- Internationalisation pact, under which the government embraced the commitment to stimulate the internationalisation process of Portuguese companies as well as foreign investment in Portugal, including the expansion the Portuguese tax treaty network to countries in Africa, Asia and Latin America, with the aim of being close to being one of the top 10 member states with the largest treaty network, and entering into tax information exchange agreements (TIEA) with jurisdictions included in the tax havens list. So far, two tax treaties, with Panama and Colombia, and seven TIEAs, with Bermuda, the Cayman Islands, Jersey, Guernsey, Isle of Man, Saint Lucia, and Saint Kitts and Nevis, have already been signed; and

- Re-enactment, with some changes, of the 2005 tax amnesty for untaxed portfolio investments held abroad, giving taxpayers a last chance to disclose, regularise and repatriate untaxed portfolio investments held abroad until the end of 2009, submitting them to a reduced special rate of 5% and fully exempt of criminal tax procedures. Furthermore, in the case of capital deposited outside the EU and consequently brought back, there are no requirements demanding that such assets stay in Portugal. This tax amnesty is in place until December 16 2010.

In the second priority area, the intensification of environmental taxation, three major measures may be listed:

- Update of CO_2 emissions limits, as far as the vehicle acquisition tax is concerned, limited to the two higher brackets that are those in which more polluting and tendentiously more luxurious vehicles fall;

- Increased compliance requirements to apply the scrapping scheme. After the 2009 policy to lower the levels of CO_2 emitted by vehicles eligible for this tax benefit, only vehicles with a CO_2 emission under 130 grams a kilometre are now entitled to the deduction on vehicle acquisition tax. And it was announced that, in the near future, it is expected that only electric vehicles will be eligible for this scheme;

- Introduction of reverse charge mechanism on the supplies of CO_2 emission rights to combat VAT fraud. In line with EU efforts to reduce missing trader fraud, whereas previously the supplier was liable to assess and deliver VAT due on supplies of CO_2 emission rights, this responsibility rests now with the purchaser.

In the area of the rebalance of the relationship between tax authorities and taxpayers three key measures are worth noting:

- Offsetting of tax claims with non-tax claims, allowing taxpayers to compensate tax claims in the process of being collected with non-tax claims of which the taxpayer is holder over the direct administration of the state;

- Authorisation granted to the government for the creation of a General Law for State Administration Charges, which must define:

- these charges' subjective and objective scope;

- material criteria for quantification;

- requirements for economic and financial substantiation; and

- criteria for increase or decrease due to extra-fiscal reasons.

This legislative authorisation makes clear that State Administration charges are subject to the principle of equivalence (often cited as the principle of user-pays or principle of polluter-pays) and that their structure and amount should reflect the cost inherent to the administrative supply or its market value;

- Authorisation granted to the government to institute arbitration as an alternative means for resolving tax disputes. The key features of this authorisation are:

- the requirement for a high level of expertise for arbitrators;

- the provision of a six-month limit for arbitrators' awards;

- the unappealable character of these awards; and

- the possibility to transfer pending cases from lower tax courts to arbitration courts as a way of making the tax justice system more efficient.

Additional budget consolidation tax measures

Shortly after the approval of State Budget 2010 and following the European Council of Finance Ministers' (Ecofin) extraordinary meeting of May 9 and May 10, at which the council and the member states decided on a comprehensive package of measures to preserve financial stability in Europe and agreed the acceleration of plans for fiscal consolidation, the Portuguese government, under pressure to take significant consolidation measures from 2010, adopted additional budget consolidation tax measures.

These measures, published in June, add to cuts in public spending already announced and are aimed at more forceful and effective control of the growth in public debt and deficit correction agenda. Portugal was put under an Excessive Debt Procedure by the European Commisssion in December 2009 and was asked to start correcting the deficit in 2010 and to consolidate by 2013. The measures, understandably, amount essentially to increases in personal income tax (PIT), corporate taxation, VAT and stamp tax.

It is curious to note that the increase in CIT was not enacted via CIT statutory rates, taking instead the form of a new state surtax (derrama estadual) of 2.5%, applicable to taxable profits of more than €2 million of Portuguese resident taxpayers whose main activity is commercial, industrial or agricultural or of non-residents with a permanent establishment in Portuguese territory. In line with the creation of this state surtax, taxpayers are also now liable to make three additional payments on account of the surtax due (prepayment mechanism), computed as 2% of the previous year taxable profit that is more than €2 million.

After standard VAT rates were cut in 2008, a general increase in the VAT rates has now been approved. Reduced, intermediate and standard VAT rates were therefore increased by one percentage point, from 5%, 12% and 20% to 6%, 13% and 21%, respectively. Intermediate and standard VAT rates applicable in the Azores and Madeira were also raised from 8% and 14% to 9% and 15%, the reduced rate remaining unchanged at 4%.

The stamp tax base was broadened to include the taxation of consumer credit. The use of credit under consumer credit facilities will therefore now be subject to stamp tax at rates that vary according to the term of such use: 0.07%, for less than one year (for each month or fraction thereof); 0.9%, from one to five years; 1%, for five years or more; 0.07%, for the use of credit under a current account, overdraft or any other form where the term may not be determined, charged on the monthly average of the total daily debtor balances, during the month, divided by 30.

Repeal of capital gains exemption

Law 15/2010 of July 26 approved the repeal of the PIT exemption on capital gains obtained on the disposal of shares held for more than 12 months, as well as on the disposal of bonds and other securities by resident individuals. The positive difference between capital gains and capital losses is now subject to a 20% special tax rate. However, in an effort to shield small investors from capital gains taxation, an exemption threshold is set for the annual positive difference between capital gains and capital losses under €500. The repeal of the exemption has an impact as well on closed-ended or mixed investment funds.

However, it is worth mentioning that, if certain requirements are met, capital gains derived by resident pure holding companies and by non-residents remain exempt, allowing valid tax planning opportunities.

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The fact that this measure applies to capital gains derived from January 1 2010 regardless of the holding period raised concerns about its conformity with the constitutional principle that prohibits retroactive taxation and opened ground to a tax dispute.

Taxation prospects

Developments in 2010 will most certainly continue to be marked by the reaction to the crisis, with an emphasis on the implementation of measures to correct the deficit.

The increase in the tax burden is already leading taxpayers to seek all available opportunities, which include:

- Legitimate tax planning regarding taxation of labour (both reacting to the taxation of severance compensations and bonuses and preparing the ground for the entry into force of the Social Security Contributions' Code, which will broaden the base of social security contributions);

- A boost in tax litigation, to which taxpayers resort more often whenever they deem the tax claim illegitimate (as is the case when tax is retroactive);

- Effective use of the variety of special tax regimes and tax incentives put in place, aimed at promoting internationalisation process of Portuguese companies, attracting qualified foreign investment, maintaining or increasing employment, supporting micro, medium and small enterprises, boosting R&D, increasing employees' levels of qualification and attracting foreign qualified professionals;

- Submission to the tax amnesty scheme recently re-enacted to attract untaxed portfolio investments held abroad;

- Efficient use of the growing tax treaty network, either as a means to cut tax costs or to promote the role of Portuguese companies as hubs to investments in tax treaty jurisdictions;

- Implementation of measures aimed at easing liquidity constraints, such as swifter and simplified VAT refund procedures recently enacted.

It is therefore clear that, in spite of the hard impact of the crisis, tax opportunities thrive.

Personal income tax increases

A new top bracket of personal income tax (PIT) was introduced for income of more than e150,000, with a top marginal rate of 45% (where the previous top bracket, with a top marginal rate of 42%, was reached at e64,623). The new top bracket was approved by Law 11/2010 of June 15 and is meant to be temporary, as it explicitly applies only to income derived in fiscal years 2010 to 2013.

Soon, however, after the approval of Law 15-A/2010 of June 30, this top marginal rate, as well as the other progressive rates, were further adjusted by 0.58% and 0.88%. Thus, PIT’s eight rates range progressively from 11.08% to 45.88%.

In line with the adjustment of the progressive rates of PIT, the withholding tax rate on payments to non-resident individuals was also increased by 1.5% to 21.5%. In addition to this, domestic provisional withholding tax rates were also raised by 1.5%, to 11.5% (income derived from supplies of services of a technical, scientific or artistic nature), 16.5% (intellectual property income, real estate income and investment income) and 21.5% (business income derived from any activities of the list mentioned in article 151 of the PIT Code).

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