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2006 State Budget

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Editorials

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The 2006 State Budget Bill is the ideal time to take stock of the current state of tax affairs and make plans for the future, not only in terms of the budget provisions but also the use to which they may be put in the course of the relationship between tax authorities and other authorities and the taxpayers. In the following articles my colleagues will discuss the proposed budget provisions and report on the present status quo.

It seems to me however that an analysis of the State/Citizen relationship is relevant and I would particularly like to emphasise three of the features of this relationship: A) The publication of the RERT (Extraordinary Framework for Regularising Tax Affairs): The government wishes to appease its relationship with the citizens, shutting out the past in return for a price. B) It promises harsher measures in the future: This is manifested from the outset by the announcement of the publication of a list of State debtors. C) The increasing involvement of the Public Prosecutor and the PJ (National Crime Squad) in tax crime investigations. All of these features together will lead to greater conflict in the State/Taxpayer relationship at every level. Taxpayers will begin to hit back, filing suit against the State and its agents seeking damages for losses arising from tax assessments and other unlawful acts, and even for crimes of slander (publicly imputing to the taxpayer acts which he did not perform). It follows that there will be a need for greater cooperation between taxpayers and their lawyers with a view to having the taxpayers comply with the law, but also, and increasingly so, to demanding that the State too abides by the law and is punished for any unlawful acts it may perpetrate. ■

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1. The State Budget Bill for 2006 is a budget that will require sacrifices to be made. Public investment will not be increased and social welfare payments will remain at the same levels, or may even be reduced, while there will be cutbacks in current state expenses and civil service salaries (which will see no real increase).

It is also a budget that seeks to pass round the burden. Employed workers will pay more tax, tax deductions for pensions and benefits will be less and payments on account will be higher.

Although the budget introduces little change, as is appropriate at this time, it seeks to provide a degree of stability for the tax system while at the same time introducing a reform of the automobile tax which will now include, as is proper, an environmental dimension, just as proposed by the European Commission.

2. The credibility of a Budget depends on its bases. There is a certain degree of realism in the projected level of growth for GNP and for the price of petroleum (65 dollars/barrel). Yet it also gives rise to many doubts with regard to the export growth rate and the actual ability to collect the amount of forecast revenue.

The rate of growth in tax revenue (6.8%) is an extremely high goal, which will require great additional effort on the part of the tax authorities, since economic growth will average at around 1.1% and will be achieved primarily through exports and not consumption. Finally, as the levels of collection have increased enormously in recent years, it will be difficult to achieve even higher growth rates.

As the different articles written by my colleagues - all tax lawyers at PLMJ - will show, the 2006 State Budget Law does not propose a coherent set of tax measures. It is in practical terms a series of increases, which fall primarily within the area of indirect taxation, aimed at obtaining increased revenue; a path which runs directly counter to that taken in other countries, where the trend has been towards decreasing taxes, thereby providing incentive for private investment and consumption.

Other measures are to be expected during the course of 2006 and there is likely to be a widening of the taxable income base and more reductions in tax benefits. We will keep you informed of developments from time to time through our newsletters. ■

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Automobile taxation

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General Features

1. The fall in the sales of private passenger cars over the last few years, and particularly the pressing need to reduce CO_2 emissions (which are specially significant and worrying), has brought automobile taxation to the forefront of government attention.

In implementing the current XVII Constitutional Government Programme as well as Resolution 161/2005 of 12 October of the Council of Ministers, which is based, among other things, on the studies carried out in 2001, the 2006 Budget brings changes to the incidence base of the Automobile Tax (the IA created by Decree-Law 40/93 of 18 February), with the tax now being calculated not only on the cylinder capacity of the vehicle but also on the "environmental component" - merely an expression that will directly and progressively associate the IA payable on any given vehicle with the corresponding "CO_2 emissions per kilometre".

Thus from an environmental viewpoint, as had been previously proposed, it is believed that CO_2 emissions are a satisfactory indicator of the level of pollution caused by the vehicle - an indicator which has become widely accepted in the community courts.

If we take into account the need for car models to be adapted to the new automobile rules, the alteration as provided for in the above-mentioned Resolution of the Council of Ministers will only begin to have effect as of July 1st 2006. In addition, the tax incentive for the "scrapping" of vehicles at the end of their useful lives (as provided for under Article 10 of Decree-Law 292-A/2000 of 15 November) will remain in effect until December 31st 2006, and the government is also authorised to simplify the corresponding procedures and rules on controlling and stimulating this practice, which seems both appropriate and opportune.

2. The reason for choosing CO_2 emissions to constitute (partly) the basis for calculating the IA is related firstly to the fact that it is widely accepted that CO_2 is harmful to the environment, particularly in terms of climate changes because it is a "greenhouse gas" (which has the effect of warming the planet) and, secondly, to the fact that this "indicator" must be included on the official documents of each vehicle under European community requirements, which, in technical terms, allows for quick and easy implementation of the proposed measure. In addition, the presence in the tax authorities' data base of the CO_2 emission levels of vehicles subject to IA allows for a statistical comparison of the tax revenue deriving from this new "type" of taxation with that which would have been charged had there been no alterations.

CO_2 emissions from diesel-fuelled engines are significantly lower than from petrol-driven cars for the simple reason that diesel is less rich in carbon than petrol. Yet vehicles which run on diesel pose a (more) serious threat in terms of particle emissions, which in turn causes additional upsets for public health. Nevertheless, as in the other European Union countries, diesel fuel is subject to a more favourable tax treatment than petrol in terms of excise duty (in Portugal diesel is subject to €0.314/litre and petrol €0.533/litre), which has led, in a diametrically opposite effect to what would be desirable, to a growing demand for diesel-powered vehicles (the market is currently made up of around 70% diesel vehicles) with a corresponding reduction in demand for petrol-fuelled vehicles. This has serious consequences not only for tax revenue but also in the growing inadequacy of the crude oil refining structure.

The Automobile Tax (IA)

3. The preceding paragraphs help us to understand the reasons why the government, just as proposed in the 2001 draft bill, included a special table for diesel-powered vehicles in the new "environment component" in the 2006 State Budget Law.

The new formula for calculating the IA will also, as seems proper, have repercussions - albeit limited initially -, on the used car market, especially in regard to cars "imported" from other European Union countries, and will tend to raise the price of such vehicles, as these are usually older vehicles with comparatively higher CO_2 emissions. If, as is also envisaged, the government should in the future increase the above-mentioned "CO2 component" and decrease the "cylinder component" accordingly, this will prompt the introduction to the Portuguese market of more environmentally-friendly vehicles, instead of offloading end of series vehicles in Portugal as is the case at present, and create simultaneous gains in terms of improved road safety.

The favourable tax treatment (40% of the IA) is to continue for hybrid vehicles, that is to say, vehicles powered by traditional fuels such as diesel and petrol in conjunction with liquid petroleum gas (LPG), natural gas (NG), electricity or solar energy, as well as for vehicles which are powered solely by LPG or NG (a laudable solution), which, besides the environmental benefits, allow for an

diversification of energy which is vital to Portugal as the country in the European Union with the highest degree of dependence on crude oil.

In a move that demonstrates its awareness of the (well-grounded) criticisms put forward by associations in the sector at the time this matter was being debated in parliament, the political power has chosen to introduce a provision, which was not contained in the 2006 government bill, exempting less polluting vehicles from the environmental component tax, and the environment is highlighted as one of the highest priorities of the economic and fiscal policies underlying the 2006 Budget, thus strengthening the coherence and foundations of the new tax "model".

4. Only time will tell whether, owing to the changes in the market structure brought about by this important alteration, the government will reach its objective of neutrality in tax revenue, or whether the tax burden involved in acquiring an automobile will be lesser or greater.

The proposed change is nevertheless in line with community guidelines such as the *Communication From The Commission To The Council And The European Parliament On the Taxation of Passenger Cars In The European Union – Options For Action At National And Community Levels of* 6 September 2002 – SEC(2002)858, which corroborate the conclusions of several studies previously carried out in Portugal. However, despite this positive sign from the government – that is the introduction of the "environmental component" of the automobile tax – the "move" from registration taxes to annual circulation taxes, as proposed by the European Commission and suggested by the studies carried out in 2001, has been put off yet again.

Circulation Taxes (IC)

5. With regard to the Council Vehicle Tax (IMV), the government simply proposes to bring the respective rates in line with the forecast rate of inflation (2.3%) but technically speaking it seems to be logical that it will be based on this tax that it uses the legislative power granted in the legal framework for "vehicles at the end of their useful lives" (cf. Decree-Law 292-A/2000), under which the use of high pollutant vehicles (with very old number plates?) is penalised, and it is to be expected that it will follow a path of the type which will now be introduced for ICI and ICA.

An "environmental component" will also be introduced for these latter taxes with effect from January 1st 2006, using the year in which a vehicle was first registered as an indicator of its environmentally-friendly status. The rate of the tax will now be progressive, based on the age of the vehicle and calculated according to five scales: pre-1990, 1991 to 1993, 1994 to 1997 and after 2000.

The rates of ICI, which is charged on private commercial vehicles (otherwise known as the "own fleet") and applies to "vehicles with a gross weight of ≤ 12 t" will be increased by between 4 and 4,5% and for heavy goods vehicles, certain "gross weight scales" have been divided in two which will allow greater differentiation in the rates of the tax. The progressive nature of the proposed tax is already of some significance since there is a tax difference of 13.9% between the oldest and more recent vehicles.

As regards the ICA, which is chargeable on commercial vehicles for professional use, there will be no changes in the rates of tax applicable to vehicles with a gross weight of ≤ 12 t" and the situation for the remaining vehicles is similar to that described for the ICI. The progressive nature of the tax is identical to that of the ICI for "motor vehicles with a gross weight of ≤ 12 t" and is lower for "articulated vehicles and combined vehicles".

We are unable to comment on the consequences as regards increases or decreases in the corresponding tax revenue as it is not easy to compare the data since the actual structure of the tax will be changed. ■

Corporation Tax (IRC)

Non-Profit Making Organisations and Private Charity Institutions

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Non-profit making organisations which provide a service to the community, private charity institutions and their associated entities, as well as other legally equivalent organisations, will benefit automatically from an IRC exemption, without needing to have received prior recognition from the Ministry of Finance.

Furthermore, in accordance with the proposed changes, this exemption will be limited to the income derived from activities carried out within the scope of the objects set out in the statutes of these organisations, thereby expressly excluding any income arising from activities which are not envisaged in the objects expressed in the statutes of the organisation in question, and also any income from bearer shares which are neither registered nor deposited.

Non-deductible expenses

Expenses incurred with documents issued by companies whose cessation of trading has been declared by the relevant

authorities of their own motion will no longer be deductible. To this end, the Tax Inspectorate General will make available information on the past record of these taxable persons.

Losses or variations on shares

As with the transfer of shares for value, other losses or negative variations concerning shares or other capital, namely special shareholders' loans, will now only be deductible at half of their value.

Transfer prices

The concept of a special relationship is expanded to include relationships between a non-resident entity with a fixed establishment in Portugal and an entity in a clearly more favourable tax system/regime.

Under capitalisation

In accordance with the under-capitalisation provisions set out in the IRC Code, when the indebtedness of a taxable person to a non-resident entity with which it has a special relationship is deemed excessive, the interest on the amount deemed to be in excess is not deductible for tax purposes.

Excessive indebtedness is deemed to exist when the amount of the debt to the non-resident entity, with reference to any point during the tax period, is over twice the amount of the stake in the share capital of the taxable person, unless it is possible to show that the same level of indebtedness could be incurred to an independent entity under analogous circumstances.

According to the proposed amendment, situations of indebtedness of a taxable person resident in Portugal to an entity resident in another European Union Member State will now be expressly excluded from the scope of application of the under-capitalisation provisions.

It will no longer be possible, however, to waive the under-capitalisation rules when there is an excessive rate of indebtedness to entities domiciled in a country, territory or region with a clearly more favourable tax system, as listed in a ministerial order from the Ministry of Finance.

Special payment on account

The ceiling for the special payment on account will be increased from €40,000 to €70,000.

Reinvestment and amortisation

The minimum period for amortising computers will be reduced from 4 to 3 years.

Redomiciling a company abroad and cessation of trading of fixed establishments of non-resident entities operating in Portugal

The redomicile abroad of a Portuguese-domiciled company will now be equated in fiscal terms to a liquidation, thereby giving rise to a determination of the taxable profit for the tax year in which trading ceases, by calculating the positive or negative differences between the market value and the book value of the assets at the time of the cessation.

The same rule will apply to the cessation of trading of a Portuguese subsidiary of a non-resident company.

This determination will not however apply whenever the assets remain at the disposal of a fixed establishment of the same company located in Portugal and certain requisites are met, for example, when these assets are booked in the accounting records of the fixed establishment at the same value as at the other Portuguese-domiciled company.

Besides the fiscal neutrality applicable to the "migration" of the company assets to the fixed establishment to be set up in Portugal, the losses determined at the time of the cessation of trading following its relocation may now also be availed of by the fixed establishment, subject to the prior approval of the Director General for Taxes, by means of an application to be filed before the end of the month following the date on which trading ceased. ■

Amendments to the Personal Income Tax Code (CIRS)

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■ The amendment to Category G income constitutes an exclusion from tax on prize money won in the Santa Casa de Misericórdia de Lisboa lotteries "Euromilhões" and "Liga dos Milhões".

■ Within the former wording, the CIRS considered a spouse who was not habitually resident in this country a resident if the other spouse resided here, and consequently imposed an obligation to file a joint tax return in Portugal for all the family income, including the income of the spouse who resided abroad.

The amendment made to the concept introduced by the 2006 State Budget Law has been done in order to avoid the current double taxation which in the former scheme of things could be corrected by applying the Convention which aimed to avoid double taxation, when it existeds or a tax credit as provided under the IRS Code, but

with the consequent and obvious administrative and bureaucratic difficulties associated with the application of such mechanisms.

The current regime aims to allow a spouse who has not resided in Portugal for more than 183 days to disapply the status of resident resulting from the above-mentioned provision, provided that the majority of his/her working activities have no connection with this country.

In such a case, the spouse who is resident in Portugal will be taxed in accordance with the provisions applicable to "de facto" separations, with the non-resident spouse being subject to income tax solely on income obtained in Portugal.

■ The 2006 State Budget Law makes provision for deducting up to 50% of the amount spend on personal computer from taxable income, including software and other computer equipment up to a maximum of 250 euros. This deduction can be used only once in the 2006 – 2008 period subject to the following conditions being met:

- the normal rate of tax paid by the taxpayer is less than 42%;
- the equipment acquired is new;
- the taxpayer has dependants who are students at any level of education or is himself/herself a student at any level of education; and
- the invoice for the equipment contains the tax number of the purchaser and contains the words "for personal use".

■ Supplementary private tutoring costs for any level of education will now be included in the concept of education expenses and can be deducted (30%) subject to the limits set out in the CIRS.

■ Itemised deductions are to be increased by between 2.2% and 3.5%.

■ A 9.45% reduction from €8.283 to €7.500 in income from pensions and benefits in order to harmonise the tax treatment of pensions and benefits with income from employment.

■ The highest rate of IRS will be raised to 42% for taxpayers whose taxable income is higher than €60,000, and IRS bands will be increased by 2.3%. ■

Tax benefits

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The 2006 State Budget Law provides for the introduction of tax benefit measures (i) for Retirement Savings Funds, (ii) in respect of transactions carried out in the Tax Free Zones of Madeira and Santa Maria Island, (iii) contractual investment, and (iv) for the acquisition of computers and other associated equipment, and also confers a power to introduce tax benefits for investment funds and a tax framework for tradable debt.

1. Tax Benefits for Retirement Savings Funds

In the State Budget for 2006 the possibility of deducting from Personal Income Tax (IRS) amounts paid into Retirement Savings Plans (PPRs) will be brought back. In effect, although the current regime does not go so far as to restore the possibility of deducting the amounts paid into Education Savings Plans (PPEs) or Retirement and Education Savings Plans (PPR/Es), it does restore part of the regime which existed prior to the entry into force of Law 55-B/2004 of 30 December (2005 State Budget Law).

According to the State Budget for 2006, IRS taxpayers will be able to deduct 20% of the sum paid into PPRs in this same year by an unmarried taxpayer or by a husband and wife who are not legally separated, up to a ceiling of (i) €400, if the taxpayer is under 35, (ii) €350 if the taxpayer is between 35 and 50 and, lastly, (iii) €300 if the taxpayer is over 50 years of age.

It must be pointed out however that the 2006 Budget also envisages an increase in the amount of tax on sums paid out by retirement savings funds, retirement-education funds and retirement and education savings funds. In effect, it doubles the taxable income base to be taken into account in situations of total or partial redemption of PPRs in the case of amounts paid by retirement savings funds, that is to say, the income will no longer be considered at one fifth, as it was before, but at two fifths. As regards amounts paid out by education savings funds and

retirement-education savings funds, these will now be taxed on the entire amount, unlike the current situation where, just as for taxation of amounts paid into retirement savings funds, only one fifth is taken into account.

Lastly, we must mention that the remaining amendment in this chapter deals with the restoration in part of the regime which existed prior to the repeal of the 2005 State Budget Law, as: (i) a 10% rise in the amount deducted for each year or fraction of a year in the case of redemption of certificates (except in the case of the death of the investor or when five years have elapsed from the respective delivery and one of the situations provided for by law occurs, (ii) payment of the tax owed by the management company, and (iii) joint liability of the management companies for the tax debts of the funds they manage.

2. Tax benefits for transactions carried out in the Tax Free Zones of Madeira and Santa Maria Island

In respect of taxable profits deriving from transactions carried out in the Tax Free Zones of Madeira and Santa Maria Island in the Azores), the State Budget Law introduces the presumption that 40% of the taxable profits of credit institutions and financial companies located in the Tax Free Zones of Madeira and Santa Maria Island concerns activities engaged in outside the institutional scope of these Zones. In other words, insofar as it concerns the entities included in the subjective scope of application of the provision in question (credit institution and financial companies that engage in trading mainly in the Tax Free Zones of Madeira and Santa Maria Island) the exemption regime is reduced to 60% of its taxable profits. Secondly, it is considered that a given entity engages mainly in trading in the Tax Free Zones when the ratio between the amount of net assets belonging to the external financial subsidiary and the value of the net assets of the institution is greater than 50%, and when this ratio exceeds 80% the Ministry of Finance may, upon the application of interested parties, set the percentage of taxable profits of the overall activity that derive from activities carried out outside the Tax Free Zones by ministerial order, thereby ousting the abovementioned “40%” regime.

3. Tax Benefits for investment of a contractual nature

With regard to this type of tax benefits for investment of a contractual nature, it imposes an obligation on all contracts concerning investment projects in Portugal to include provisions that will safeguard the returns gained in respect of the tax benefits granted in the event of the cessation of trading of the beneficiary.

4. Tax benefits for the acquisition of computers and other computer equipment

Similarly to the situation in point no. 1 above, there is also in this case a proposal to restore the deduction regime in effect prior to the commencement of Law 55-B/2004 of 30 December (2005 State Budget Law). Iin effect, 50% of the amount spent on acquiring computers for personal use, including software and other computer equipment, will be deductible up to a ceiling of €250. It also provides that this deduction may only be used once during the 2006-2008 period and will be subject to certain provisos: (i) the normal rate of tax paid by the taxpayer is less than 42%, (ii) the equipment acquired is new; (iii) the taxpayer or any member of the household is a student at any level of education; and (iv) the invoice for the equipment contains the tax number of the purchaser and contains the words “for personal use”, since the grant of this benefit works to the detriment of the use of equipment for professional purposes. An acquisition made during the month of December 2005 will also be eligible for the purposes of applying this deduction in 2006.

5. The power to legislate on tax benefits for investment funds and the tax regime for tradable debts

Finally, the Budget aims to confer a legislative authorisation to amend taxation provisions on investment funds by establishing a reduced rate of IRC for income from these funds and for IRS and IRC on income distributed to the holders This proposed amendment constitutes a clear sign, of international competitiveness.

The government is also authorised to amend the IRS and IRC provisions on capital income and capital gains deriving from public and non-public debt securities with a view to excluding from their net non-resident entities over 20% held, directly or indirectly, by entities domiciled in Portugal and catching in the tax net central banks and other governmental agencies of countries, territories or regions with clearly more favourable tax systems, as contained on the list approved by the Ministry of Finance. ■

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Value-Added Tax Measures

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The VAT section of the 2006 State Budget sets out new measures on: (i) providing incentive for the cancellation of claims, (ii) the criteria for deductibility of VAT for amounts due which fulfil the requirements of Article 71(9) of the VAT Code, (iii) control and credibility of invoice details, and (iv) the prevention of transactions aimed at evading taxes.

1. Incentives for terminating judicial claims

The 2006 State Budget, following the path announced at the time the "Action Plan to Free Up the Courts" was presented on September 26th 2005, provides incentives for terminating by withdrawal, settlement, admission or arbitration agreement any claim or enforcement proceedings filed prior to September 30th 2005 (no alteration, extension or narrowing of the claim made after this date will be taken into account), when the withdrawal, settlement, admission or arbitration agreement takes place before December 31st 2006.

In relation to Corporation Tax (IRC), this will allow the deduction of the amount of the claim in such proceedings for the purposes of determining the taxable profits, if the above-mentioned conditions are met.

As regards VAT, the amounts in respect of which the VAT already paid by the creditor can be deducted differ according to the status of the debtor. Thus, in cases where the debtor is an exempt taxpayer who is not entitled to make deductions, and also in cases where the debtor is a private individual (and because there is no risk of loss of income), the creditor can deduct the tax paid in transactions of amounts in excess of €10,000; likewise in cases where the debtor is a taxpayer who is entitled to make deductions, the legislature sets a limitation on the right to deduct the VAT paid by the creditor based on a maximum transaction figure of €7,500.

2. Measures relating to the alteration to the deductibility criteria (Article 71(9) of the VAT Code)

With regard to the amendment to the VAT Code, the 2006 State Budget increases the amount of debts in respect of which the tax is deductible under Article 71(9) of the Code.

Therefore, in cases where the debtor is a taxpayer who is entitled to make deductions, the VAT in respect of sums of less than €6,000 (in the current wording the amount is €4,987.98) provided that these have been acknowledged in a claim for payment or in enforcement proceedings and the debtor has been served by advertisement.

On the other hand, when the debt is a private individual or a taxpayer who engages solely in VAT-exempt transactions which do not afford a right to make deductions, the VAT in respect of debts of not more than €750 can be deducted (under the present wording the limit is €349.16) provided that the delay of the debtor in payment is greater than six months.

Furthermore, when the debtor is an individual or a taxpayer who engages solely in exempt transactions which do not afford a right to make deductions, the VAT in respect of amounts of more than €750 and less than €8,000 will now be deductible (currently the limits are €349.16 and €4,987.98 respectively), provided that (*i*) an enforcement order was appended in proceedings for the recovery of a debt or acknowledgement in an action for payment or *(ii)* the debtor is listed on the enforcement proceedings electronic register as a defendant against whom enforcement proceedings were filed but suspended for want of seizable assets.

Creditors, in order to show that the debtors do not own seizable assets – and consequently for their right to deduct to be acknowledged – will now be able to consult the enforcement proceedings electronic register under the terms set out in Decree-Law 201/2003 of 10 September, which enacted the Legal Framework for Enforcement Proceedings Electronic Register (which will also be amended so as to enable the register to be used for this purpose), with the aim of ascertaining whether the defendant against whom the enforcement proceedings were filed but suspended due to the absence of seizable assets does in fact not have any seizable assets. In our view, this is probably the most important amendment since it means that the VAT on the amounts owed will now be deductible when the computer system verifies that the debtor in question owns no seizable assets.

3. Measures on the control and credibility of the invoice details

In relation to tax fraud and tax evasion, the first items of note in the 2006 Budget are the amendments aimed at combating the corruption of computer functions and/or electronic data in an age where the use of computer systems as an operating base for the administrative and financial processes of organisations is widespread, particularly in the business world.

It proposes that VAT taxpayers who use their computer systems to issue invoices or other tax-relevant documents guarantee the operational integrity of such systems and the integrity of the

electronically-stored data, as well as the availability of the relevant technical documentation.

In order to implement this operational integrity, the computer systems of such taxpayers must ensure in the future (i) controlled access to system functions (permissions management), (ii) the existence of control functions – integrity, accuracy and reliability – and detection of alterations to the data, (iii) the preservation of all data necessary to reconstitute and check the accuracy of the processing of tax-relevant transactions, and (iv) that there are no functions or programmes which would allow information to be altered outside of the documented control procedures or do not generate a trail of evidence linked back to the original data.

Guaranteeing integrity is now understood to mean that the data is stored securely and that the tax authorities can have access to and will be able to read the stored data.

Lastly, it requires that the technical documentation necessary for demonstrating the operational integrity of the computer systems is available, accessible and readable.

In this context, amendments are also made to the General Taxation Infringements Law, with a view to making provision for and punishing, not only the use of programmes, data or electronic files whose objective is to bring about a decrease in tax revenue, but also the creation, transfer or exchange of programmes created for this purpose.

4. Anti tax fraud and evasion measures (legislative power)

The 2006 State Budget Bill renews the power to legislate which was conferred in the 2005 State Budget Law and which, in the context of creating anti-abuse provisions, is specially aimed at real estate transactions, and provides for the adoption of specific provisions which prevent tax fraud and tax evasion in relation to real estate transactions, whether these are conveyances, leases or other types of transfer.

The objective of this legislative power is to prevent the practice of undervaluing at the time of transfer of real properties and the associated services, when the person for whom these are performed is a taxpayer who does not have the right to claim full deduction of the tax paid, or when there are special relationships between the taxpayer and the transferor or service provider.

Further, it provides that in transactions which take place between taxpayers, the beneficiary of the service associated with building construction, as well as the purchaser, lessee or transferee, in the case of transactions involving real properties subject to tax, even if by option, is defined as the debtor for the tax.

Finally, it authorises a review of the requisites for exercising the right to waive VAT exemption, thereby introducing restrictions on the right of waiver both in cases involving taxpayers who do not have the right to claim full deduction and in case where there are special ties between them. ■

Administrative and Judicial Tax Procedure

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In what the Administrative and Judicial Tax Procedure is concerned, the 2006 State Budget Law provided an authorisation to legislate with a view to harmonising the provisions set out in the Administrative and Judicial Tax Procedure Code with those of the General Taxation Law, the Civil Procedure Code and other legal instruments arising from the reform of administrative litigation, the 2006 State Budget, only introduces changes to the time limit established by the Administrative and Judicial Tax Procedure Code for filing an administrative complaint as well as to several of the provisions of the General Taxation Law.

The time limit for filing an administrative compliant was increased from 90 to 120 days. This alteration does not result in a general extension of the time limit for administrative complaints. In fact, under the current wording of the above-mentioned article 70(1) of the Administrative and Judicial Tax Procedure Code, the 90-day time limit for filing an administrative complaint is equivalent to the time limit which the taxpayer has to file a judicial claim against the act he is aiming to protest, as this legal precept refers expressly to the time limit set down in Article 102(1) of the same Code.

Under the terms of this change, it is expressly established by Article 70(1) of the Tax Procedure and Process Code that the time limit is 120 days and any reference to Article 102 of this same Code is removed, with no indication of the time from which the time limit begins to run. Thus, it appears that the 120-day time limit will always have to run from the date of notification of the decision which originated the administrative complaint (with the exception of the provisions of Article 140 of the CIRS under the proposed wording).

As regards the administrative complaint in respect of tax assessments, while the time limit for filing an administrative complaint will be 120 days from the date of notification, the time limit

for filing a judicial claim will continue at 90 days from the end of the period for voluntary payment of the amount assessed. In practice, these time limits may or may not coincide, since, if nothing contrary results from the notification of the tax assessment, the time limit for voluntary payment is 30 days (cf. Article 85(2) of the Tax Procedure Code).

This change will allow taxpayers to make payments on account, within the voluntary payment period, if they have in the meantime complained against part of the respective tax authorities' assessment decisions, thereby avoiding the payment of default interest on the amounts which are not in dispute.

As regards other types of tax authority decisions, the time limit for filing an administrative complaint will be 30 days longer than the time limit for filing a judicial claim in respect of the same decisions. However, this extension of the reaction period only for decisions which do not involve the assessment of tax do not seem to be justified or to present any advantages in the case of simultaneous recourse to administrative and judicial means under the principle of joining tax claims.

The 2006 State Budget Bill also repeals Article 70(2) and (3) of the Taxation Procedure and Litigation Code thereby eliminating the one year time limit for filing an administrative complaint against tax authorities' decisions based on a failure to comply with prescribed formalities or on the total or partial absence of legal existence of these decisions.

The changes made to the time limit will only be applicable to time limits which begin to run after January 1st 2006.

In relation to the General Taxation Law, amendments are made to Articles 24, 64 and 78 which refer respectively to the framework for subsidiary liability for tax debts, to the principle of fiscal confidentiality and to the administrative review procedure.

Article 24 of the General Taxation Law also extends subsidiary liability for tax debts to accountants when there has been a breach of the duties of accountability for the accuracy of accounting and tax records or of the signing off of tax returns, financial statements or appendices.

As regards tax secrecy, it will now be possible to divulge lists of taxpayers whose tax affairs are not in order, as well as the publication of income declared by the taxpayers in accordance with lists compiled by the tax authorities.

Finally, in relation to the procedure for administrative review of taxable income, Article 78(4) of the General Taxation Law will be amended to provide for the possibility of the head of the service authorising a review of the determined taxable income on the grounds that serious and blatant injustice has been done, in the three years following the tax authorities' decision in cases where a blatantly exaggerated and disproportionate sum has been determined, with the proviso that "the mistake is not due to the negligent conduct of the taxpayer". ▪

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Amendments to the General Tax Fraud an Tax Evasion Regime

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In the wake of the national plan to combat tax fraud and tax evasion, one would expect greater amendments to the sanctions of the type of conduct defined as tax crime or administrative offence, namely regarding changes to the abstract moulds applicable to the different types of administrative offence or crime.

However, an analysis of the State Budget reveals the contrary; the removal from the sanctions framework certain conduct which is punishable as tax crime under the current legislation.

In effect, up to now Article 103(2) of the General Taxation Infringement Law only made provision for conduct which resulted in an unlawful wealth increase of less than €7,500 not to be punishable as tax fraud.

Now, the 2006 Budget Law provides that conduct which results in a wealth increase of under €15,000 will no longer be punishable criminally – as tax fraud.

Approval of this measure will imply from the outset the closure of pending criminal cases aimed at punishing conduct that had led to a wealth increase of between €7,500 and €15,000. In fact, as in Portuguese criminal law the principle of the application of the law which is more favourable to the defendant applies, this measure will have immediate application, including in those cases where the aim is to punish acts which took place prior to its entry into force.

Likewise with reference to the crime of abuse of fiscal trust provided for and punishable under Article 105 of the General Taxation Infringements Law, the number of cases where the taxpayer will not be punished will be greater. In effect, according to the Budget, if the amount unlawfully appropriated by the taxpayer is equal to or less than €2,000, criminal liability will lapse if within 30 days of notification to this end, he pays the amount of tax due, plus interest and the minimum fine for the administrative offence of failing to pay the amount of tax due.

However, at the administrative offence level, there is in addition to the introduction of a new type of offence, an increase in certain administrative offence scales and also an increase in the list of those who are liable subsidiarily for the payment of fines.

As regards the administrative offence of "Placing Products incorrectly on the Consumer Market", the maximum fine applicable to situations of placing on the consumer market or marketing products which are in violation of the sealing, labelling or marketing rules set out in the Excise Duty Code has been doubled to €300,000.

In relation to tax administrative offences this law, if passed by Parliament, will place electronic programmes, data or files on the same footing for the purpose of punishing any refusal to file tax relevant documents.

As mentioned above, given the subjective expansion that the Budget aims to introduce, accountants will now be subsidiarily liable for the payment of fines arising from the delay in or failure to file tax returns during the period in which they perform their duties.

Finally, a new administrative offence is created, which will be included in the new article 128 of the General Taxation Infringements Law – which punishes what is known as Electronic Falsification - according to which "any person who creates, transfers or exchanges computer programmes designed for the purpose of preventing or altering the accurate determination of the taxpayer's affairs, when not punished as a crime, will be subject to a fine of between €500 and €25,000".

This new administrative offence in conjunction with the introduction of a new clause 2 to Article 118 of the same law – whose wording is unfortunate and equivocal – is a response to the new practice of unlawfully designing or using computer programmes and electronic data to falsify the taxpayer's affairs, with the objective of obtaining financial increases which may give rise to reduced tax revenue. A justifiable move given the fact that many of the tax-significant transactions engaged in by the taxpayers can be carried out by means of computers, particularly via Internet: *Ubi Societas ibi Ius*.

On a final note, it is our view that the fact that the current wording of Article 118(2) has been maintained will necessarily create loopholes for certain types of atypical conduct. It could always be asked whether the legislature intended to extend the limits of punishment for conduct whose relevance in terms of administrative offences purely and simply does not exist, in which case such a decision needs to be examined from a constitutional viewpoint, event though we are in the field of mere administrative offences law. ▪

Excise Duty Under the 2006 State Budget

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I - General Considerations

1. The 2006 State Budget Lawl presented to Parliament by the government envisages several amendments to the general section of the Excise Duty Code (CIEC) which raise comments in several respects.

Amendments aimed at perfecting the wording of certain legal provisions, thus bringing the code into line with the General Taxation Law, and eliminating loopholes, are not important for our purposes here.

2. This is not the case, however, with the amendments to the status of the registered trader and the tax representative, who will now have to comply with any "procedures established by the customs authorities". In effect, although this provision is already included in the wording of the statute of the approved warehousekeeper and thus seeks to harmonise the wording of the three statutes (registered trader, tax representative and approved warehousekeeper) it is, in our view, an unhappy choice since it remains to be clarified what form the procedures set out by the legislature will take: statutory instrument, ministerial order, or oral instructions? Even if this last option is not actually envisaged (as it indeed appears to be), the doubt impacts adversely on the legal certainty and safety which ought to guide relations between the tax authorities and the holders of the special statutes set out in the CIEC.

3. Another item worthy of mention is the amendment to the guarantee given by the tax representatives and approved warehousekeepers, which will undergo a major increase from 20% to 25% of the average monthly value of the products released for consumption in the previous year, and whose minimum amount will double from €24,939.89 to €50,000. This (abrupt) increase in the

minimum guarantee shows that the tax authorities intend to reduce to a minimum the number of economic agents who can operate with Excise Duty but at the same time reveals less attention to the conditions necessary for the competitiveness of Portuguese companies.

4. Finally we cannot but comment – as a sign of the times – on the new wording of the General Taxation Infringements Law which doubles (to €300,000) the ceiling of the fine applicable to infractions involving the incorrect marketing of consumer products and similar acts.

II - Duty on Alcohol and alcoholic Beverages

5. The amendments to the duty on alcohol and alcoholic beverages aim, on the one hand, to increase the rate of tax in line with the forecast rate of inflation (2.3%) and, on the other, to extend the number of traders who can under certain circumstances acquire special stamps.

III – Duty on Petroleum and Energy Products (ISP)

6. The rates for the duty on petroleum and energy products will increase in line with the forecast inflation for the more minor petroleum products (gases used in fuel, acetylene, etc.)

7. As regards diesel and petrol, the State Budget for 2006 also sets out the variation intervals for the ISP rates within which the government, and also, the regional governments, are authorised to set the rates of tax. Given the range of these intervals, it is only the direction of the Government's fiscal policy, which is public knowledge(see the Programme for Stability and Growth (PEC)), that allows that the actual increase of the rates of these products will vary ,as all signs indicate ,between Euros 0,0250 and Euros 0,0368 per litre In other words, even with the price of crude oil, at its highest level ever , the Government feels "obliged" to increase the tax in the retail price by 10% for petrol and 7% for diesel.

This situation is quite worrying since it will significantly increase the tax disparity in Portugal and Spain with the gravest of consequences as regards the competitiveness of the economy (diesel) and tax fraud (petrol).

IV – Tobacco Duty

8. The amendment to tobacco duty aims not only to bring the respective rates into line with the forecast rate of inflation, but also to make provision for the tax increase that the Government has undertaken to bring in based on the PEC. It is therefore expected that the retail price of a packet of cigarettes will increase by between €0.30 and €0.35.

While the legitimate right of the government to increase taxation on these products is undeniable, particularly given the danger they constitute to health, we can only compare once more the reality in Portugal with the reality in Spain, which is yet again unfavourable to Portugal and creates the usual consequences of commercial subterfuge and fraud.

V - Biofuels

9. Biofuels have been the subject of community harmonisation under Directive 2003/30/EC of 8 May, which has not yet been transposed into domestic law, as it should have been before the end of 2004 but which should now come about before the end of this year. The directive only addresses the definition of products which may be used as raw material in the production of biofuels and establishes percentages for blending biofuels with traditional fuels by means of an annual calendar starting at 2% in 2005 and reaching 5.75% in 2010.

10. Despite certain doubts as to the interpretation of the directive, the general understanding in several Member States is that the percentages for blending biofuels over the years are merely pointers and that the Member State is therefore not legally responsible for any breach. What is settled is that the traditional fuels can contain certain percentages of biofuels (provided that they continue to comply with the demanding technical specifications in force in the sector), but no Member State is obliged to grant an exemption or reduction in the ISP rate on biofuels: each Member State itself will decide whether, in order to pursue its own policies (environmental, health, agriculture, industry, etc), it will exempt or reduce the rate of tax on biofuels, bearing in mind that on a community level the aim is to develop this sector for environmental reasons of safe delivery, diversification of energy resources and agricultural-industrial development.

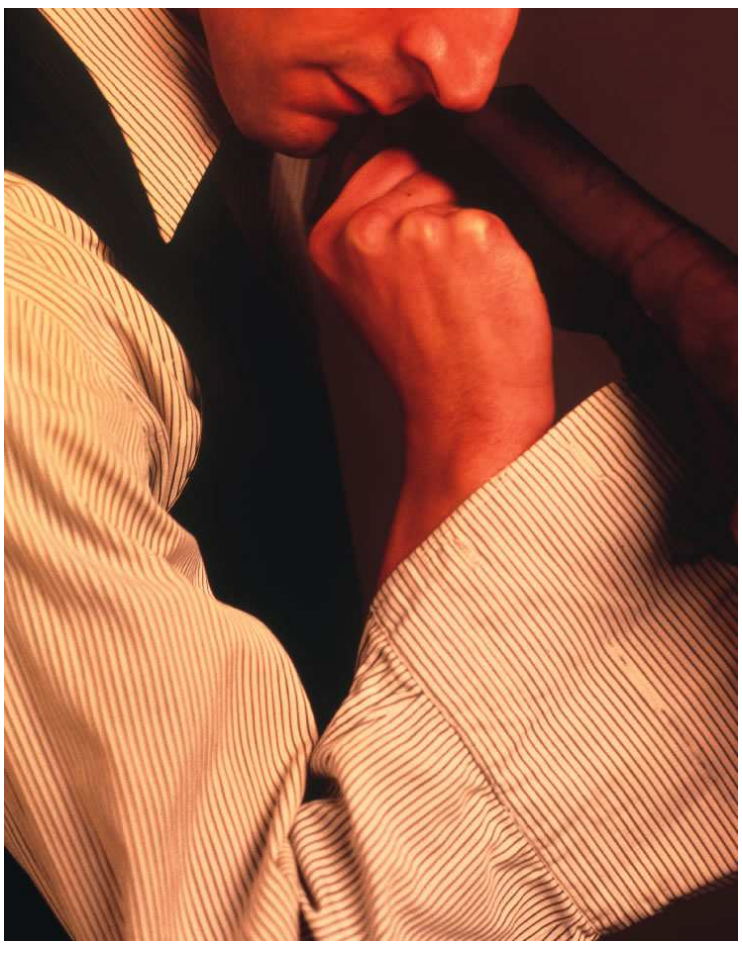
11. The 2006 Budget confers power on the government to introduce legislation exempting biofuels from the ISP.

This time, the wording is more careful and forms a stark contrast with the unhappy wording of the provision in the 2005 State Budget which professed an identical objective. Indeed, the legislature is careful to explain that biofuels may either be exempted from the tax itself or only benefit from a reduction in the rate if this should this be necessary as a result of developments in the prices of biofuels and traditional fuels. This feature, which is extremely important in avoiding excess profits for purely fiscal reasons, is dealt with unambiguously and the temporary nature of this tax benefit is clearly established (a maximum of six years).

12. The legislative authorisation also has the merit of "linking" the exemption from ISP to commercial and industrial activity – by stating that it is based on "a multi-annual programme" for the supply of biofuel – which is convenient since it makes little or no sense to give up very high tax revenue (ISP exemption) without any return for the economic development of the country. This legislative power also safeguards the community principle of "no tax discrimination on goods produced in other Member States" by providing that this framework applies also to imports. It must be used appropriately, or there is a danger that high tax revenue will be sacrificed without any corresponding return for economic development. It is probably the fact that it will mean a fall in tax revenue along with uncertain economic benefits that has led some Member States not to exempt any quantities of biofuels from the tax.

13. Since the fact that the refining industry in Portugal produces too much petrol and not enough diesel, we believe that in the use of the legislative power the ISP exemption should only apply for biofuels which can be added to diesel. In terms of quantity this should not exceed 1.5% of the diesel market, which is around 110 million litres per year (typical size of a certain type of refinery) which even so would still mean a loss of around €35,000,000 in reveuen.

14. Furthermore, despite the improved wording conferring the power to legislate this year in relation to last year, we notice that the *range* is not sufficiently defined as it provides that the biofuels may be totally or partially exempt from ISP, but says nothing as to the maximum quantities of the product to be exempted (either as an absolute value or, as provided in the directive, as a percentage of the total fuel market), with the result that, in practice at least, there is nothing except for minor technical restrictions on vehicle engines to stop the fuel market from being saturated in biofuels, thus leading to a complete loss of ISP. Contrary to how it may appear at first glance, this is not a mere academic point, since the versatility of automobile engines as to the fuel that they are able to use grows daily. The gravity of the situation is clearly visible to those who are interested in such things and constitutes a good argument against the inclusion of radical tax changes in the State Budget, given the difficulty in getting the appropriate constitutional control mechanisms to act in good time. ■



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