NEWSLEXTTER

2009: 10 SIGNIFICANT TAX NEWS ITEMS

TAX LAW

PLMJ

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2009: A New Legal and Economic Framework

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The 2009 State Budget was prepared during the second six months of 2008 and enacted by Parliament in October of last year. It was however prepared under certain assumptions which did not materialise; the eurozone went into recession in the third quarter of 2008, that is to say, there was a negative growth in GDP during the last two quarters which is expected to worsen in 2009, the Bank of England interest rates in the British pound zone reached their lowest level (1.5% in 315 years!) while the European Central Bank also lowered the euro interest rate on 15 January, drawing near to its all-time low (2%).

The very credible official German institution - the ISW - even admitted that it was possible that German GDP would decrease 3% in 2009. Production at the three largest American car manufacturers dropped between 30% and 40% in 2008. French car company Renault also saw sales fall worldwide by over 4% in 2008. In Spain, the number of cars sold fell by over 40% in 2008 while the sale of houses decreased 28% in October last year.

The Bank of Portugal too announced a more pessimistic forecast. The GDP level predicted for Portugal in 2009 was to decrease to -0.8% while inflation in 2009 would not exceed 1% and unemployment would reach 8.6%. And that very credible German institute – the ISW - forecast inflation in the region of 0.6% and unemployment of around 8.9% for Portugal.

The 2009 State Budget Bill was therefore prepared and enacted on the assumption of a growth in GDP in the eurozone of 1.3% in 2008 and 0.2% in 2009 and of a growth in Portuguese GDP of 0.8 in 2008 and 0.6 in 2009, as well as an inflation rate of 2.5% and an unemployment rate in the region of 7.6%.

In other words, in relation to the main indicators:

	2009 Budget	BP	ISW
GDP	+0.6	-0.8	-
Inflation	2.5	1	0.6
Unemployment	7.6	8.6	8.9

The budget forecasts soon turned out to be very difficult to achieve. And in a year like 2009 when the world economy is either in or on the road to recession – particularly our main trading partners, Spain, France and Germany – forecasting has become more difficult.

As a result, the 2009 State Budget approved In October 2008 was in irremediable need of a "rectifying" or "supplementary" budget – at heart a budget amendment – wherein the government would have to reconcile the latest developments in the Portuguese economy and was also expected to revise downwards the estimated revenue for some or all taxes. And as there is nothing to point to a decrease in expenditure – nor would this be desirable – the budget deficit is likely to rise above the 3% limits.

As regards direct taxes and personal and corporate income taxes (IRS and IRC respectively), the economic recession is likely to lead to stagnation or even a decline in revenue in 2009.

There will be contradictory effects as regards IRS, since it is likely that there will be a fall in revenue from the private sector and a slight increase in revenue from the public sector, as the civil service salaries were raised by 2.9% and the tax rates increased. With regard to IRC, the decrease in profits and the halving of the rate applicable to the first €12,500 of profit, as well as the production crisis and other tax benefits created in the meantime, should lead to a fall in revenue.

In relation to indirect taxes and particularly VAT – which in recent years has provided higher tax revenue – this is likely to level out or probably even decrease, simply as a result of the reduction of the normal rate from 21% to 20% in mid-2008 and of the decline in the Portuguese economy. Yet there could also be a pleasant surprise owing to the effect of the increased income available to civil service families, given the difference between the 2.9% pay rise and the inflation rate recently forecast by both the Bank of Portugal (1%) and other institutions (0.6%), which would have a positive effect on spending and consequently the amount of VAT levied. It all turns on whether this increase in people's available income (at least 1.9%) will be earmarked for saving or spending.

The amount of revenue gained from Stamp Duty is also likely to diminish due to the decline in economic activity.

With regard to excise duties, tobacco and alcohol duty will tend to remain unaltered. The fall in the price of oil may mean increased spending and some favourable repercussions for the duty on Petroleum Products.

Lastly, we are likely to see somewhat contradictory effects with regard to the municipal property taxes (IMI and IMT) due to the increase resulting from the updated tax registers and the decrease because of the reduction in the IMI rate, and the balance may be a negative one.

In short, forecasting the budget for 2009 is an "extremely risky" exercise, which has already led to a supplementary budget. This is clear from the European Commission forecasts and the most recent data for Portugal in 2009 – decrease of -1.6% in GDP, 8.8% unemployment, 4.6% deficit, and Portugal - along with Spain - is one of the two countries in the eurozone whose growth rate is expected to remain negative (-0.2%) in 2010.

I - Anti-cyclical Tax Measures

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Law 64/2008, of 5 December, makes provision for several of the tax measures known as anti-cyclical and amends the IRS; IRC and IMI Codes and the Tax Benefits Statute (EBF), effective from 1 January 2008.

The amendments to the IRS Code

The separate taxation rate on the expenses of Category B taxpayers (with organised accounts) has been amended. The rate of separate taxation on deductible expenses related to representation charges and light passenger or commercial vehicles, motorbikes and mopeds has been raised to 10%. The 5% rate of separate taxation on deductible expenses with light passenger or commercial vehicles with CO_2 emission levels of less than 120g/km for petrol engines and less than 90g/km for diesel remains unchanged.

The Law provides that deductions from the amount of tax due can no longer result in a net income of less than that which would result if the taxable income was equivalent to the upper limit of the next lowest tax band.

The limits on deductions in respect of main permanent dwellings from the amount of tax due have been increased: (i) interest and debt amortisation payments, (ii) rentals, and (iii) instalments owed on contracts entered into with housing cooperatives, according to the taxpayer's taxable income:

- up to €7,017; the deduction limit is €879 (increased by 50%);
- up to €17,401: the deduction limit is €703.20 (increased by 20%);
- up to €40,020: the deduction limit is €644.60 (increased by 10%).

The amendments to the IRC Code

There has been a 10% increase in the separate tax rate on deductible expenses related to representation charges and light passenger or commercial vehicles, motorbikes or mopeds of non-exempt taxpayers whose main activity is commercial, industrial or agricultural in nature. The 5% rate continues to apply to deductible expenses related to representation charges and light passenger or commercial vehicles, varying as for IRS on the basis of CO_2 emission levels.

The separate tax rate on deductible expenses paid by taxpayers with light passenger or commercial vehicles with an acquisition cost of over €40,000 has been increased to 20%.

The third payment on account will now fall due on 15 December of the year to which the taxable income relates. Despite the amendment having effect from 1 January 2008 - the limit for the next payment on account must be 15 December – this time limit was extended to 31 December.

The amendments to the IMI Code

The maximum IMI rates have decreased from 0.8% to 0.7% (unvalued properties) and from 0.5% to 0.4% (properties which have already been valued in accordance with the IMI), and the municipal council may set a different rate for each parish.

The amendments to the EBF

The exemption period for IMI on main permanent dwellings has been raised from 6 to 8 years for properties with a taxable value of up to €157,500 and from 3 to 4 years for properties whose taxable value ranges from €157,500 to €236,250, and covers situations where the previous exemption period is running or ends in 2008.

The Robin Hood rate

In the 2008 financial year and thereafter, the positive difference between the gross production margin computed using the FIFO (*first-in, first-out)* method or average weighted cost method to cost the raw materials used and the margin computed on the basis of the costing method used in the accounts will be liable to a separate IRC tax at the rate of 25%. In practice, companies manufacturing or distributing refined oil products have to use one of these two methods.

It is provided that this separate tax is not deductible against IRC in individual or group accounts and any repercussion of this charge on the price of the products sold is prohibited. The Competition Authority is responsible for enforcing this measure.

We shall see whether the effects of these measures will make themselves felt in the short term.

II – Adapting to the New Accounting Rules

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The 2009 State Budget Law (currently awaiting publication) confers legislative power on the government to have the tax system adapted to the International Accounting Standards (IAS) as well as to the new internal accounting rules arising from the adaptation to the IAS (i.e. the Accounting Standardisation System - SNC – which will replace the present Chart of Accounts (POC), thereby introducing amendments to the IRC Code and its supplementary legislation.

In terms of the above legislative power, it is possible to predict what main measures will be introduced for this purpose, the most significant of which are highlighted below. The intention is to integrate structurally into the IRC Code the transitory tax regimes for adapting the IAS to the banking and insurance sector, as well as in relation to pension funds.

With regard to the rules on tax deductibility, adaptation to the IAS will imply accepting the tax deductibility of short-term benefit expenses with employees, officers and directors in the tax period in which they are stated, as well as the deduction of expenditure on shares during the tax period in which the rights or options are exercised or the amounts paid. It will also allow the deductibility of provisions for covering expenses with guarantees to clients as well as the direct deduction of expenditure or losses from bad debts as a result of a non-judicial conciliation procedure to turn around companies in insolvency or economic difficulty mediated by IAPMEI (Instituto de Apoio às Pequenas e Médias Empresas e à Inovação (IAPMEI). It also provides for the exclusion, for deductibility purposes, of capital losses made on leisure boats, aircrafts and light passenger or commercial vehicles except when these are equivalent to the tax depreciable value.

The results for building contracts will now be determined according to the finishing percentage method.

Also worthy of note is the amendment to the special tax neutrality regime that applies to mergers, splits and asset contributions which eliminates the requirement for the transferred assets to be stated in the accounts of the beneficiary company at the same value as in the accounts of the merged, split or contributing companies.

It is also intended to expand the reinvestment regime to capital gains and losses made on tangible fixed assets, such as investment properties, under the conditions currently set for capital gains and losses on corporeal fixed assets.

Excluded from taxation will be the asset variations arising from the issue of financial products and included in the taxable profit will be the gains from an application of the fair values of consumable biological assets and of financial instruments classified as "financial assets or liabilities at fair value by way of results".

Provision has also been made for a review of the depreciation and amortisation regime to accept the respective deductibility without requiring it to be stated as an expense in the accounts.

There will also be an increase to €1,000 of the acquisition price of low value items capable of being amortised in just one financial period, as well as the increase of the maximum depreciable limit of light passenger or commercial vehicles to €40,000.

Provision is made for the repeal of Article 14 of Decree-Law 35/2005, of 17 February, under which IRC taxpayers are obliged, for tax purposes, to keep organised accounts in line with the national accounting standards and legal provisions in force for the respective sector of activity.

As provision is made under the 2009 State Budget Law for the suspension of the simplified regime currently in force for IRC in such a way as to diminish the impact of the transition to the new accounting provisions, a new simplified regime will be created for determining the taxable income of small-sized taxpayers, which will establish simplified tax rules based on the accounting standards applicable to these taxpayers.

The government has therefore until the end of 2009 to adapt to the new rules, after which time the legislative powers conferred in the State Budget Law will lapse. We must hope that the government will not allow this time limit to go by and will make it possible for all traders to meet the conditions for the full application of the IAS as from 2010.

III – The New Binding Information

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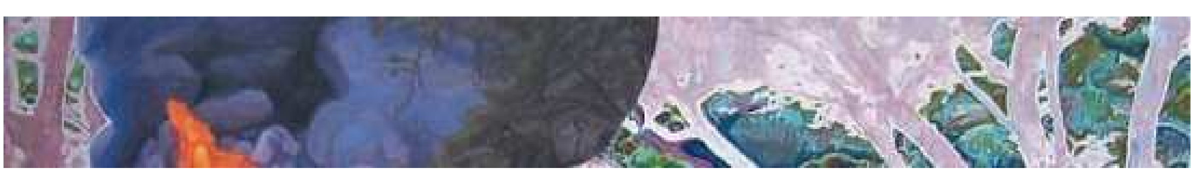
The 2009 State Budget Law contains several amendments to the Binding Information regime, which are worth highlighting owing to the potential they have to make cooperation between the tax authorities and the taxpayers more transparent, speedier and, above all, safer and more accurate. Through the use of binding information, taxpayers are able to request information on their actual tax status and still unspecified requirements for tax benefits, thereby facilitating the computation of the actual “tax cost” of a given operation or transaction or the value of a certain tax benefit and binding the tax authority not to decide otherwise at a later stage. In other words, these requests can be a way of reducing the risks associated with an ever-more complex tax system and allowing for a reduction in state costs.

Experience has shown that the tax authorities are unable to respond to these requests fully and promptly (it is not uncommon for the reply to come many months or even years later), which deprives them of any practical usefulness. In order to overcome this problem, the recent amendments introduced by the State Budget Law provides for notice of the reply to the taxpayer to be served within 90 days (when the general response time was previously six months) at the risk of having any of the taxpayer’s liability limited - when the latter acts on the basis of a plausible good faith interpretation of the law – to only the amount of tax owed, without any possible fines, interest and other legal charges in respect of the period between the end of the time limit for providing the information and its being served on the applicant. But the lawmakers have gone even further by creating the urgent Binding Information, in which case, 60 days are proposed for the reply. In order for the taxpayer to avail himself of this service, he must apply for the appraisal and justify its urgent nature and also enclose a proposed tax framework. For all requests filed after 1 September 2009, the interested party’s proposed tax framework will be deemed tacitly approved by the tax authorities if no reply has been received by the end of the sixty-day period. This effect – tacit approval – is however restricted to the acts and facts set out in the request and to the tax period in which they occur. The urgent Binding Information is also subject to a charge of between €2,400 and €9,600 (perhaps excessive) based on the complexity of the matter - a criterion for which the lawmakers neglected to supply a definition. This is a not insignificant detail, particularly if we take into consideration that the binding information can be revoked after one year with future effect.

Let us dare hope therefore that in the near future the appraisal periods for urgent binding information will gradually transform into standard time limits so that this instrument will become accessible to taxpayers in general, regardless of their financial capacity. Perhaps we could also hope for additional changes which in our opinion would contribute to a speedier process, including the possibility of it being easier for taxpayers to request the application of existing Binding Information to their own specific cases.

If implemented successfully, these amendments to the binding information regime are already an important contribution towards a much closer and overdue collaboration between taxpayers and the tax authorities.



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Ricardo Angélico
Detail
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IV - The New Tax Regime for Non-Residents

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The 2009 State Budget Law envisages a series of IRS measures aimed at non-residents. It makes it possible for a non-resident to apply for a refund of tax withheld on income deriving from certain service provisions and introduces a new optional regime for residents in other European Union (EU) or EEA (European Economic Area) Member States which allows them to opt to be taxed according to the rules applicable to taxpayers resident in Portugal.

It establishes therefore the possibility of a resident in another EU or EEA Member State applying for the return of the tax withheld on income from a given provision of services on the part that exceeds the amount that would be owed by a Portuguese resident. The return of the tax withheld and passed on to the state should be requested from the relevant section of the Directorate-General of Taxation within a period of two years from the end of the calendar year following that in which the taxable event took place and carried out by the third month after all the information and details necessary for appraising the application have been filed.

This proposal came about in the wake of the proceedings filed by the European Commission against the Portuguese state on the grounds that the taxation rules applicable to non-residents were discriminatory and, as such, incompatible with the freedom to provide services. In effect, income arising from services provided by non-residents was subject to a definitive withholding tax without any possibility of having the tax returned, while residents are only taxed on their net income.

Another article has been added to the IRS Code which sets out an opt-in regime for residents in another EU or EEA Member State (with which there is an exchange of tax information).

Within the scope of this new regime, it will be possible for these taxpayers to opt to be taxed in accordance with the rules applicable to unmarried taxpayers resident in Portugal, provided that 90% of their income derives from employment income (Category A), business or professional income (Category B) or pensions (Category H) obtained in Portugal.

Furthermore, whenever the taxpayers in question are married or cohabiting, they may opt to be taxed jointly on the income earned by members of the household, such as resident household members, provided that (i) both taxpayers are resident in another EU or EEA Member-State, (ii) the Category A, B or H income obtained in Portugal by the household members is equivalent to at least 90% of the total household income and (ii) the option is expressed by both taxpayers or their legal representatives.

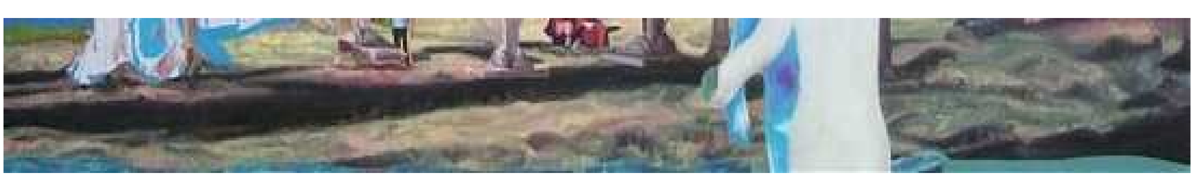
In this way, non-residents may benefit from tax deductions enjoyed by resident taxpayers, which is not the case at present as the former are obliged to pay tax on the gross income and are not allowed any deductions. In effect, they may now make all the deductions that resident taxpayers can deduct from the amount of tax due (which results from applying the IRS rate to the gross income), namely health, education, residence and insurance (among other) expenses, provided that these expenses could be deducted in the state of residence.

Regardless of the exercise of this option, income obtained in Portugal is subject to withholding tax at the rates that apply to income earned by non-residents, whether these are provided for in Portuguese law or in a tax treaty aimed at the avoidance of double taxation or some other international law agreement that binds the Portuguese state. However, whenever these taxpayers exercise the option to be taxed in Portugal, the amounts withheld take on the nature of a payment on account, which will be deducted or refunded after the final computation of the IRS due.

It should be noted that the exercise of this option must be indicated in Income Tax Form 3 which must be filed within the time limit applicable to resident taxpayers, that is, between February and May, depending on the type of income earned and the format of the return (printed copy or internet). The taxpayers must file documentary evidence that the conditions for the regime to apply have been met while the Directorate-General of Taxes can request the taxpayers or their representative to file, within 30 days, the documents it deems necessary to ensure that the regime is being used correctly.

Lastly, a legislative power has been provided for the creation of a tax regime for non-habitual IRS residents. This new regime is designed to attract highly specialised (expatriate) foreign professionals who carry on high value-added activities of a scientific, artistic or technical nature and subject them to a more favourable tax regime.

Besides their immediate effect of avoiding a ruling against the Portuguese state in the proceedings initiated by the European Commission for alleged discriminatory treatment of non-residents, these measures could in time attract income to this country.



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V – The Charge for Second Valuations

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In the State Budget Law, the introduction of a charge to be levied on the taxpayers for the legitimate exercise of the right of defence must be highlighted - applications for a second property valuation will now have to be paid for. Each time that a taxpayer disagrees with the tax value attributed to his or her property and applies for a review of the valuation, the state coffers will grow by between €480 and €1,920 "according to the complexity of the process". This measure is open to criticism on two fronts: firstly, it appears to make no sense to oblige the taxpayer to pay a – significant – sum in order to exercise his or her right to consider the assessment of their property illegal (although if they are right and the difference is more than 15%, the sum will be refunded). Secondly, not only are the minimum and maximum limits high but they are dependent on an inadmissible degree of administrative discretion (complexity of the process) which has the potential to lead to unfair outcomes, especially if used as an additional source of revenue. Thirdly, real estate is valued by means of a formula in which the size, location and various features of the property involve increases or decreases of its value. As this is an operation which almost never varies, it begs the question as to how there can be especially complex situations which justify differences in the order of €1,440.

Lastly an "escape valve" is introduced which allows the committee to set a new tax value, for the purposes of IRS, IRC and IMT, whenever the valuation formula results in a tax value of more than 15% over the market value of the property. This provision seeks to mitigate certain situations of tax injustice where the IRS, IRC and IMT Codes presume a certain income if the tax value exceeds the transaction price. In other words, in the current regime, if A sells a property to B for €100,000 but, under the IMI Code provisions, the tax value of this same property is €120,000, A will pay capital gains as if the proceeds were €120,000 and B will pay IMT also on the sum of €120,000, even if the actual transaction price is only €100,000. Under the new regime, the taxpayer can be taxed on or closer to the real value of the transaction without having to go through the process of rebutting the presumption (which involves lifting bank secrecy), thereby avoiding some litigation as the differences in tax would no longer justify the expense of such litigation.

With regard to IMI, as this is levied on the tax value and not on market values, it will be paid on this value (whether it results from the first or the second valuation) and not on any market value that may be set by means of the escape valve for the purposes of IRS, IRC and IMI.

Leaving the most complex question – the market value – until last, we would say that, from an economic viewpoint, this is equivalent to the minimum price that the seller is willing to accept and the maximum price that the buyer is prepared to pay for a given property at a given moment in time. In this case, we would speculate that the state will resort to transaction prices in the same geographical area for houses of a similar age and type -because it has access to such information - (finding similarities particularly in the criteria used in the calculation of the tax value). Nevertheless, as the abstract criteria it is, it would seem to be leaving the door open for disagreement between the states and the taxpayers with the obvious consequences, including increased litigation. It is important therefore that the market value of the property be determined as objectively as possible.

VI - The New Rules for VAT on Services

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The 2009 State Budget Law contains a legislative power from the Parliament to transpose Council Directive 2008/8/EC of 12 February into national law. This Directive has been published in the EU Official Journal and provides for the inversion of the general rule that is currently applicable in the Member States as regards the place of supply of services for the purposes of Value-Added Tax (VAT), which will now be taxed in the Member State of consumption instead of the Member State in which the provider is domiciled or has his registered office.

The government is now authorised to amend the VAT code to establish the place of registered office, permanent establishment or domicile of the receiver of the services as a general rule for locating the place of supply of services made to VAT-taxable persons. Thus, whenever a service provider does not have his registered office, permanent establishment or domicile in national territory and the receiver is a Portuguese VAT-taxable person, the general rule is that the tax will be (self-) assessed in Portugal.

The following special provisions are however established: transactions related to properties, including the provision of accommodation, will be taxed at the place where the property is situated, (ii) passenger transport services - at the place where the transport is provided, according to the distance travelled, (iii) the provision of cultural, artistic, sport, scientific, educational and similar services as well as restaurant and catering services will be taxed at the place where the services are materially provided, (iv) restaurant and catering services on board ships, aircraft or trains during the transport of passengers within the Community - at the place of departure and, finally, (v) the short-term hire of transport - at the place where the good is placed at the disposal of the receiver of the service.

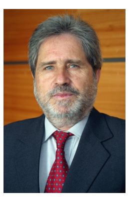
With regard to the provision of services to private individuals, the current general rule of taxation in the Member State of the registered office, permanent establishment or domicile of the service provider continues to apply.

In this case, the following situations/exceptions are also provided: (i) the provision of services by an intermediary acting in the name and on behalf of another will be taxed at the place where the underlying transaction was carried out, (ii) the provision of transport of goods, with the exception of intra-community transport of goods - at the place where the transport is carried out, according to the distance travelled, (iii) the intra-community transport of goods - at the place of departure, (iv) the provision of additional transport services, specialised services and work related to movable tangible property - at the place where they are materially provided, (v) telecommunication, radio and television broadcasting services provided electronically by taxable persons with their registered office, permanent establishment or domicile outside the Community - at the place where the receivers have their domicile or habitual residence, (vi) when provided to non-taxable persons established or domiciled outside the Community - at the place of domicile or habitual establishment of the receiver of the following services: transfers of copyright, patents, licenses, industrial and commercial trademarks and similar rights, advertising services, consultancy, engineering, studies, legal, accounting and similar services, as well as data processing and the supply of information, obligations to refrain from pursuing or exercising in whole or in part a business activity or a right referred to in this subclause, banking, finance and insurance operations, with the exception of renting safes, supply of staff; hire of movable tangible goods with the exception of means of transports, access to the natural gas and electricity distribution systems, as well as the provision of transport services through these systems and the provision of other directly-related services; telecommunications services; electronically-provided radio and TV broadcasting services.

Lastly, the following services will always be liable to VAT in Portugal: (i) hire of transport means by providers that have no registered office, permanent establishment or domicile in the Community to non-taxable persons, when their actual use takes place in national territory, as well as (ii) the lease of tangible movable property, with the exception of means of transport, by providers with their registered office, permanent establishment or domicile in national territory to residents outside the Community, when the actual use of these goods takes place in national territory.

Although the Portuguese government is now authorised to amend the VAT Code as set out above, these amendments will only come into force as from 1 January 2010, as provided in the directive.

VII – The New Vehicle Tax Rules



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Automobile taxation, both at the acquisition (licence) stage or at the road stage was recently the subject of a reform which has been in force since July 2007.

With regard to taxation on light passenger vehicles at the acquisition stage, the Automobile Tax (IA) was abolished and replaced by a new Vehicle Tax (ISV). The main changes concern the taxation on carbon dioxide emissions - which went from 10% to 60% of the value of the tax (at the same time the cylinder component changed from 90% to 40%) - and codification, since legislation which was previously scattered over more than a dozen legal instruments is now contained in one single code.

As regards the taxation of vehicles at the road stage, the old Road, Road Haulage and Municipal Vehicle Taxes were abolished and replaced by a Single Road Tax (IUC). The tax continues to be payable annually but is no longer assessed and paid in one single month (normally July); it now falls due in the month in which the vehicle is licensed and annually thereafter.

Just as with the ISV, the IUC rates for vehicles licensed after 1 July 2007 now include an environmental component that taxes the *CO^2 emissions* and *age* of light passenger vehicles and imposes heavier taxes on old heavy goods vehicles with older registration licences.

The confessed aim of this legislative reform was to "transfer" around 50% of the ISV value from the acquisition stage (ISV) to the road stage (IUC) in order to facilitate the renewal of the fleet and afford greater stability to tax revenue. For budget reasons, the transfer will be made progressively over a period of five years.

As a year and a half has elapsed since the reform began, it is safe to say that there was no transfer of revenue from the acquisition stage to the road stage in 2007, as the IA/ISV revenue was greater than that of the previous year, however, IUC revenue (only on light passenger vehicles) was insignificant (around €6.3 million). In 2008, when the sales of the taxed automobile market had stabilised, ISV revenue declined around 25% in comparison with the previous year, which seems to point to the reform developing effectively.

We hope however that the heavy increase of the ISV environmental component rates in the 2009 State Budget does not bring the entire process back to square one, as this would bring about a decrease in the credibility of reform made in an important economic sector.

The prevailing winds from the IUC side are not favourable either, as the government decided to create an authentic addition to the tax rates that apply to vehicles registered in 2008 and 2009. This higher tax at the road stage (IUC) ought to bring relief from (or at least maintain) the tax burden at the acquisition (ISV) stage but this was not the case as ISV rates were significantly increased.

With such erratic moves in tax policy, we must wait and see how the automobile sector will cope in 2009 – a year in which severe economic crisis is expected.

VIII - Correcting Tax Authority Mistakes

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At a time of increased pressure in tax collection, taxpayers are now faced with the new guarantee provided for in the 2009 State Budget Law - the "procedure for correcting tax authority mistakes". The aim of this mechanism is to allow for material or blatant tax authority mistakes to be corrected more quickly. To this end, the injured taxpayer should apply for the mistake to be corrected within ten days of becoming aware of the detriment. The application itself should be decided by the head of the department within fifteen days. But just as with most gifts, "there are no batteries included" - the procedure does not suspend the running of administrative or judicial time limits and cannot find as to the illegality of the assessment or even whether the tax is due.

Is the guarantee *new?*

In tax proceedings, the taxpayer is entitled to participate in the decision, where he can point out the mistakes made by the tax authority. The exercise of the right to be heard serves the purpose of allowing the taxpayer, prior to the final decision, to point out the errors made by the tax authority, which must be corrected before the final decision. In essence, the procedure is not new but a modernised version of the gift they gave us ten years ago. Even so, the new mechanism is not useless, but it is superimposed on an existing procedure which, if used zealously and well, allows for mistakes to be corrected. However, it allows for them to be corrected at stages where the taxpayers knows or is obliged to know the rights and duties subsequent to his or her exercise of the right to be heard.

Is it *really* a guarantee?

As a process that is intended to be quick and formality-free, useful even without the aid of specialised advice, it may turn into a booby trap. The taxpayer may resort to this procedure and, as a layperson, consider that having complained to the head of the department, his rights are guaranteed. However, even though the tax authority must, if necessary, invite him to file the appropriate form of reaction, if the fifteen day time limit for deciding is not observed or if the taxpayer only learns of the mistake at a later stage, this invitation to file the correct reaction form may already be useless as the time limits for filing an administrative or judicial challenge may have elapsed. For example, a complaint about the acts of the tax enforcement body must be filed within ten days, even if the taxpayer learns of the mistake and uses this new procedure on the same day, by the time the decision is given, the legally appropriate means of reaction will no longer be usable and this will have an adverse effect on the taxpayer.

Could it really be a guarantee for the tax authority *itself?*

With the co-operation of the taxpayers, the tax authority will now be able to cover any gaps at procedural stages where it can still correct them without adversely affecting the exercise of its right to assessment. In other words, the taxpayer may effectively lose arguments that would lead ultimately to the annulment of the assessment and, consequently, the non-payment of tax, as mistakes that could ultimately nullify the assessment can be avoided because of the application filed by the taxpayers.

All the efforts toward the – rapid – defence of legality are laudable and it is truly important to promote guarantees that can be used from the outset by the taxpayers, even without professional assistance, but these should come supplied with special care, including the suspension of other administrative or judicial time limits which would otherwise complicate the rules of defence.

IX - The New Bank Secrecy Rules

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Among other amendments in administrative and judicial procedural matters and taxpayers' guarantees in general, the government took advantage of the State Budget Law to introduce certain adjustments for access to information and documents covered by bank secrecy and information about financial operations.

With regard to the derogation from –rapidly waning – bank secrecy, this new amendment has been implemented by means of a surgical intervention in the text of the General Taxation Law which, in the guise of a merely formal option, introduces a substantial modification to the balance of powers between the tax authority and taxpayers in this regard.

It should be recalled that under the legal framework in force at present, the tax authority may, in the course of its powers to inspect the taxpayer's compliance with tax obligations, access information and documents protected by bank secrecy without requiring court authorisation to do so, in a range of situations expressly provided for in the above-mentioned law.

This same law, however, in a rather complex manner, establishes various levels of access to such information, both as regards the scope of the information itself and the guarantees and means of defence at the disposal of the taxpayer, including the requirement to hear the subject or not prior to taking the decision or the effect of any appeal that may be lodged against such a decision (which may have the effect of suspending or simply returning the case, as the lodgement of the appeal may or may not avoid the immediate access of the tax authority to the information requested).

Before this and since the 2000 tax reform, unlimited access to any bank information or documents without a prior hearing of the taxpayer and without an appeal on the part of the taxpayer to avoid access to such information (also known as direct access) was restricted to situations in which there were indices of the commission of a tax crime or specific facts indicating that what was declared in the tax returns was not the truth.

At the other extreme, where access was limited to certain bank documents, subject to the prior hearing of the taxpayer and a possible appeal with suspensory effect, there were some other situations of taxation by indirect methods, whether due to the impossibility of providing proof of the income (evidence-based tax) or a lack of proportion between the declared income and the external signs of wealth.

This state of affairs would be changed by the 2009 State Budget Law, which expanded the range of the above-mentioned direct access situations to include indirect taxation by a lack of proportion between the declared income and the wealth evidenced, maintaining only evidence-based tax situations at the most protected level.

Apart from any justification of another nature, yet again some of the government's options in this matter are incomprehensible from a legal point of view. From the outset, experience has taught us that in most situations such discrepancies arise not from any irregularities but from the existence of inherited assets or income which, as they are taxed solely by withholding tax (e.g. share income), do not need to be declared, but the door has now been opened and taxpayers are likely to see their privacy invaded in a disproportionate manner. In addition, the law provides for the amount of income to be set automatically based on the value of the asset, thereby ruling out any inspection.

There could certainly be underlying assets acquired through offshore companies in some of these cases and maybe the justification for this new widening of state powers lies along this line of reasoning. But in such a case, as in most fraud cases (which have been behind successive proposals for amending the law), this would already be covered by the range of situations for which direct access was already possible, provided that the tax authority possessed indicia of the existence of such companies.

Beyond this, it is not clear why the government continues to protect - to the clear and inexplicable benefit of the infringer - the remaining substantially more serious situations of taxation by evidence-based methods, resulting for example from the absence of accounts or false accounting.

In view of the current framework, the question that needs to be asked is obvious: as the door is open for lifting bank secrecy in most situations, is there any reason to continue to maintain bank secrecy in this form?

X – The new Real Estate for Residential Letting Investment Funds

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In order to invigorate the housing rental market, particularly in view of the real estate crisis at even national level, the 2009 State Budget Law – Law 64-A/2008 of 31 December - provided for the creation of a specific regime which would run until 31 December 2020. This regime applies to new Real Estate for Residential Letting Investment Funds (FIIAH) created between 1 January 2009 and 31 December 2013 and to the properties acquired by such funds during the same period. The FIIAH are closed-end public funds which, after the first year, must have a minimum of 10 million euros when created by public subscription and at least 100 unit-holders, while at least 75% of their assets must be located in Portugal and destined for permanent residence.

In order to make this collective investment instrument more attractive, the 2009 Budget sets out a range of associated tax benefits. Most importantly, the exemption from corporation tax (IRC) on any income earned by the FIIAH and the exemption from property transfer tax (IMT) and property tax (IMI) on buildings destined for letting as permanent residences for as long as they belong to the fund. It also sets out a favourable tax regime for investors, who are exempt from personal income tax (IRS) and IRC on income from the FIIAH units, in line with the trend towards favourable treatment of non-resident investors and resident individuals in investment funds generally. Nevertheless, unlike the situation with investment funds in general, a positive difference between the capital gains and losses arising from any disposal of property is excluded from the scope of the exemption.

Furthermore, in order to make these funds more flexible and encourage their use, mortgage loan borrowers who dispose of the mortgaged property to an FIIAH may enter into a rental agreement with an option to purchase the property from the fund, which may be exercised up to 31 December 2020. **The owner therefore, under the regime governing the funds, can combine the sale of the property with the rental and ultimate repurchase of the same property.** A specific tax regime also exists for these latter situations: an IRS exemption on capital gains arising from the transfer of the property to the FIIAH and a Stamp Duty (IS) exemption on all acts related to or associated with the transfer. If the tenant (previous owner of the property) terminates the rental agreement or fails to exercise the purchase option on the property, the capital gains obtained beforehand will be taxed under the general terms. Conversely, in cases where the purchase option is triggered by the tenants of the FIIAH properties, there will be IS and IMT exemptions on the purchase of a property as a main permanent residence. In addition, 30% of the rents paid by the tenants will be tax deductible (IRS) up to a maximum of €586.

If the tenant does not intend to exercise the purchase option, he still has the right to receive "capital gains" that is to say, the amount of the difference between the value of the future disposition of the property to third parties and the value of the updated transfer of the same property to the FIIAH, minus the amounts of the costs of placing the property on the market in normal conditions of use, any rents in arrears and also, in the event of an early termination of the rental agreement, the value of the rents for the period between the time of early termination of the contract and the time of the disposition of the property to a third party (limiting the rents due until the end of the rental agreement) . **Further, if it is difficult or impossible to dispose of the property in question through no fault of the fund's management company, the payment due to the tenant will be made within a maximum of two years after the termination of the rental agreement.**

In view of the current economic climate, it is likely that the new regime will be welcomed by private individuals who are having difficulty in paying off their loans, although it remains to be seen whether access to these funds will be easy or indeed whether investors will opt for real estate-related products, under conditions which apparently tend to favour the property owners.

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