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# Tax Measures introduced by the Amending Budget Law

## I - Scope

**1.** The law amending the Budget Law – known as the *Orçamento de Estado Rectificativo* (Amending Budget) – which the Assembly of the Republic approved on 6 July last has come in the wake of Resolution 44/2005, published on 29 June, to support the main measures of the 2004-2009 Stability and Growth Programme ("SGP") that is aimed at reducing the deficit - estimated will attain 6.8% this year - to under 3% and at combating tax fraud and evasion.

From among the rules the Assembly of the Republic approved – that will come into force on the fifth day following that of their publication in the Official Gazette – the distinction should be made between those that are direct and immediate legislative amendments and those that are solely legislative authorisations issued to the Government and that it may, and probably will, come to use in the course of this year.

**2.** As regards the former, emphasis should be placed on the following: taxation of income generated by the sale of real property by natural persons, under cover of company shares; elimination of the rule allowing - under the tax credit system within the scope of international double taxation - for the recovery of tax paid abroad in the case of insufficient assessment; restriction to the right to deduct losses, where there is a change in ownership of shareholdings or majority voting rights; increase of the time limit - from one to two years - to correct material or calculation errors in VAT records or returns, voiding the possibility of applying for this correction to this Director-General for Taxation within four years; reinstatement of Stamp Duty on cash gifts and establishment of the assumption that values deposited in joint accounts belong to their holders in equal parts and that the balance of bank accounts the deceased was entitled to operate form part of the estate; joint and several liability of natural or legal persons and of the directors and managers of the latter participating in or authorising the withdrawal of freely transferable deposits without their producing evidence that Stamp Duty has been paid or that such deposits are exempt from this duty; under Ministerial Order 257/2005 of 16 March, conferring of powers to investigate tax crimes to the Directors of the *Direcção de Serviços da Inspecção Tributária (Tax Inspection Central Services) and* of the *Direcção dos Serviços de Investigação da Fraude e de Acções Especiais (Fraud Investigation and* Special Actions Central Services).

Decree-Law 62/2005 of 11 March, which transposed the Savings Directive, is also amended with a view to overcoming the restrictions on the duty of confidentiality currently imposed on entities subject to the requirement of providing information on this type of natural persons' income, and also includes – as in Italy, Germany, Greece and Belgium and as recommended by the OECD – an exceptional system for the regularisation of assets placed abroad by natural persons, indirectly seeking that these be repatriated to Portugal.

**3.** As regards the legislative authorisations, amendments are foreseen that will, notably: establish uniform withholding tax rates on the dividends of residents and non-residents; make investment in the public and private Portuguese debt by non-residents more attractive; and where VAT is concerned, prevent undervaluation practices in the transfer of real estate and reformulate the billing and registration system in sectors of activity where tax evasion and tax fraud repeatedly occur.

Amendments to the *Lei Geral Tributária (General* Tax Law) and to the *Código de Procedimento e de Processo Tributário (Tax*

*Proceedings Code) are again foreseen, aimed at* harmonising these with the recent amendments to the *Código de Processo Civil (Code of Civil Procedure) and to those* deriving from the reform of administrative proceedings in terms of their lapsing, limitation period, appeals and procedure to review taxable income, interest, secondary liability, seizures, sales, summonses and notices, time limits, certificates, powers and acts subject to specific tax proceedings rules.

**4**. Although it not desirable for structural tax amendments to again be made, notably in budget (amendment) laws, there is no doubt that the Portuguese tax system does not appear to require further profound (called structural) reforms. What it does need, aside from the overall review and reassessment of tax benefits (that it seems are approaching), are far greater stability and normative and organisational simplification and, above all, dedicated, coordinated and increasingly efficient management. However, emphasis should be placed on the need to proceed to the real evaluation of the overall tax burden on natural and legal persons, including compliance costs as well as charges and other levies and contributions – special, parafiscal and other – which, without effective control and in substitution of budget transfers, are proliferating in the official journals.

## II - Taxation of dividends

**5.** The Government has been granted a legislative authorisation to review the taxation of dividends system, notably the Individual Income tax (IRS tax) and Corporate Income Tax (IRC tax) thereon, in order to prevent what is known as "dividend laundering", with a view to:

(a) establishing the same IRS or IRC withholding tax rates not exceeding 25% irrespective of the beneficiaries residing in Portuguese territory;

(b) attributing a final nature (that of discharge) to the IRS tax withheld, where the dividends are earned by taxpayers subject to IRS tax who reside in Portugal, the option of including these in the tax return being maintained, as it was before the coming into force of the current system;

(c) establishing a special tax rate for dividends from external sources received by natural persons residing in Portugal, which must be the same as the above-mentioned withholding tax on dividends, i.e. of no more than 25%;

(d) reviewing the separate taxation, at the rate of 25%, of dividends from internal or external sources generated by shareholdings held for a period of less than one year by persons subject to IRC tax and residing in Portuguese territory who benefit from exemption of capital-derived income tax; and

(e) eliminating the exemption from withholding IRC tax on dividends of shareholdings held for a period of less than one year.

## III - Exceptional tax regularisation system

**6.** The purpose of this new system is to encourage the tax regularisation of assets consisting of deposit, deposit certificates, securities and other financial instruments held abroad by taxpayers who are natural persons, by paying a 5% tax thereon.

This new system applies to assets located outside Portuguese territory on 31 December 2004 and confers the adhering taxpayers a "tax pardon", in so far as their adhesion will cause, on the one hand, the extinction of the applicable tax obligations in connection with the above items and, on the other, the exclusion of liability for tax infringements resulting from unlawful conducts taking the form of concealing or altering facts or values that should be shown in the returns submitted or provided to the tax administration.

Where the assets kept abroad are Portuguese Government bonds, the rate will be cut in half (from 5 % to 2.5%) in the part corresponding to these bonds.

This reduction (to 2.5%) will also apply to other assets if the value thereof is reinvested in Portuguese Government bonds by the date the tax regularisation is presented, in which case these must be kept for three years.

Taxpayers wishing to adhere to this regularisation system are required to go, by 16 December 2205, to a branch of any bank established in Portugal or to the Bank of Portugal and there pay the above-mentioned 5% (or 2.5% where applicable) and fill in a form that will constitute proof of their having adhered to this system.

The failure to adhere, will, in respect of the non-declared, omitted or inaccurately declared assets, result in a 50% increase in the tax payable on the income they generate.

Lastly, to be pointed out is that assets located in countries or territories that are considered as non-cooperating by the Financial Action Group (GAFI) may be excluded from the new system. In practice, this means that in certain cases the repatriation of assets may not be viable under the new rules set out in the law under analysis.

## IV - Taxation of capital gains

**7**. According to the rules presently in force, capital gains generated by the sales of shares held for more than 12 months are not subject to IRS tax.

As a result of the amendments now introduced and irrespective of the length of time the shares are held, the capital gains generated by the sale of shares in companies is now subject to IRS tax at the rate of 10%, where more than 50% of the assets of these companies are directly or indirectly composed of real properties located in Portuguese territory. Thus, after the new rules come into force, the rates of the capital gains tax on securities will be as follows:

(a) Where the "quotas" have been held for less than 12 months – 10%;

(b) Where the "quotas" have been held for more than 12 months – 10%

(c) Where the shares are in "non-real estate" companies and have been held for less than 12 months – 10%;

(d) Where the shares are in "non-real estate" companies and have been held for more than 12 months – not subject to tax;

(e) Where the shares are in "real estate" companies and irrespective of the time they have been held – 10%.

For IRS tax purposes, capital gains subject to tax shall generally be the difference between the sales price and the purchase price, the latter not being updated by applying monetary devaluation coefficients, as is the case for IRC tax.

Also to be pointed out is that the value subject to IRS tax does not correspond to each capital gain considered individually, but rather to the positive balance calculated annually between the capital gains and capital losses on the sale of shareholdings and other securities having occurred during this period of time. The above-mentioned 10% rate will apply to this positive balance between the capital gains and capital losses.

Although it should be disclosed in the tax return, the calculated (positive) annual balance should not be aggregated to the other types of taxable income received by taxpayers, notably for purposes of determining the applicable IRS tax rate, which ranges between 0% and 40% (42% as of 1 January 2006), unless the choice of including it is expressly applied for by the taxpayer.

Lastly, reference should be made to the fact that the new tax rules will only be applicable to transactions (capital gains) made as of the date the new law comes into force and will thus apply to previously acquired shares.

## V - Tax credit under international double taxation

**8.** The rule of the international double taxation tax credit system whereby the deduction of the tax on income of any nature paid abroad may be made within five years, in the event of the income for the year to which this income relates being insufficient to recover the tax paid abroad, is eliminated.

## VI - Deduction of tax losses

**9.** A new limit to the conditions under which tax losses in a given tax year may be carried forward and deducted from the tax on profits of the following tax year has been introduced.

Thus being, in addition to the change of the company object and of substantial change in its business activity, the change in the ownership of at least 50% of its share capital or majority voting rights having occurred between the tax year in which the losses were generated and that in which their deduction is sought will cause the loss of the right to carry these losses forward and deduct them.

Given that the law refers the change in ownership of capital and voting right to the date of the close of the tax year, the question is to know, with respect to changes in taxpayers' shareholding structure having occurred before the date this law comes into effect, whether the limit now introduced will apply to the deduction of losses registered in previous financial years.

We believe that the new tax rules will only apply to operations carried out after the date this new law comes into force.

## VII - The EU "Savings Directive"

**10.** The "interest" covered by the so-called EU "Savings Directives" that are paid by entities owing them in Portugal whose actual beneficiaries are persons residing in third Sates or territories with which Portugal enters into agreements or covenants aimed at their effective taxation can now be communicated to the relevant tax authorities, this communication being mandatory in the case of the offshore territories listed in article 15 (2) of Decree-Law 62/2005 of 11 March, which transposed the Directive into the Portuguese legal system.

Also foreseen is the derogation of banking secrecy in the situations of exchange of information on income for which the Directive provides.

## VIII - Value Added Tax

The main measure consists of the legislative authorisation given to the Government to introduce legislative amendments to inhibit transactions aimed at preventing, reducing or delaying the VAT in transfers, leases or assignments of any other nature of real properties or independent parts thereof.

The amendments to be introduced consist in establishing the taxable value of real property transfers and restrictions to exercising the right to waive exemption from VAT in real estate transactions, where the parties have a special relationship, notably due to being members of the same group or involving taxpayers not entitled to the full deduction of this tax.

As regards the system to waive exemption from VAT, to be noted is that the proposed alterations were already foreseen in the legislative authorisation granted by Law 55-B/2004 (The 2005 Budget Law).

## IX - Stamp Duty

**12**. The non-taxation of free transfers *inter vivos* or *mortis causa* of cash, particularly of call or term deposit accounts with banks is now revoked.  However, the exemption in favour of the spouse, ascendants and descendants has been maintained.

In line with this amendment, the withdrawal of any deposits, namely with banks, having been transferred free of charge is prohibited prior to the new holder producing evidence of payment of the applicable Stamp Duty or of the transfer or purchaser being exempt from this Duty.  The failure to comply with this rule will cause the depositary entity and its directors or managers to be jointly and severally liable for the payment of the applicable Stamp Duty.

## X - Tax Procedure and Proceedings

**13.** The legislative authorisation given in the successive Budget Laws, even before the reform of tax proceedings, may signify that amendments to the General Tax Law and the Tax Proceedings Code will be made with a view to harmonising them with the current wording of the Code of Civil Procedure and of the new *Código de Processo dos Tribunais Administrativos (Code of Procedure of the* Administrative Courts) and *Estatuto dos Tribunais Administrativos e Fiscais (Statute of the Administrative and Tax* Courts).

The target issues of this harmonisation, which have already been outlined in the legislative authorisation are, as has already been mentioned herein, lapsing, limitation period, appeals and procedure to review taxable income, interest, secondary liability, seizures, sales, summonses and notices, time limits, certificates, powers and acts subject to specific tax proceedings rules.

In light of the extensiveness of the herein mentioned issues is it rather difficult to anticipate, firstly, which of these will be the object of the passing of laws by the Government now in office and, secondly, the actual significance of these amendments, given that this harmonisation does not appear to justify profound changes. ■

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