BENEFITS OF REFORM

Tax laws in Portugal have been amended in line with the European Union to improve competition and fairness. Rogerio Fernandes reports

This article provides a brief overview of the Portuguese tax system, as far as corporate income tax and tax benefits are concerned, and refers to the latest developments implemented by the 2007 State Budget Law and the local finance law, which came into force in January.

Portugal has a modern and increasingly sophisticated tax system. Over the past few years, far-reaching reforms have taken place which have resulted in fairer and more competitive taxes. The current income taxation system is a result of the 1988 reform, in force since 1 January, 1989.

Both Portuguese personal income tax and corporate income tax constitute modern taxation forms — the former being designed to tax income in a global and personalised way and the latter being based mainly on the actual profit of the companies.

Municipal property tax and municipal property transfer tax are two taxes allocated to local authorities. The former is levied annually on the property value of both urban and rural real estate, whereas the latter is charged according to the value of real estate transfers.

VAT is charged on the consumption of goods and services, currently at one of the three following rates: 5%, 12% or 21%. In Madeira and the Azores, the rates are 4%, 8% or 15%.

Furthermore, there are several taxes levied on the consumption of certain goods. Among these, the most important ones are the tax on oil products, the excise duties on tobacco, alcohol and alcoholic beverages — all somewhat harmonised across the European Union (EU) — and the tax on motor vehicles. In addition, stamp duty has a significant impact on financial and insurance activities.

Recently, fraud and tax evasion have been severely fought. According to the Treasury Department, tax revenue rose 7.2% in 2006. This increase represents tax revenue to the amount of €2.18bn (£1.46bn). Corporate income tax revenue, for example, has also risen by 16.1%, exceeding forecasted provisions by €490m (£328m).

Portugal has entered into double taxation conventions with virtually every EU member state, except for Cyprus and many non-EU countries, such as Brazil, Cape Verde, Canada, Chile, Korea, the US, India, Indonesia, Mexico, Mozambique and Venezuela, among others.

The corporate income tax is based on the actual profit of companies or other legal entities, whose registered office, effective management or domicile is located in Portugal, including their profit generated abroad (worldwide income for residents).

Currently, the corporate income tax general rate is 25%. Several years ago, the general corporate income tax rate was 36.5%, whereas since 2004 the rate has been 25%, a figure much closer to the average rate charged by EU countries. In addition to the general tax rate and as a means for their own financing, municipalities charge companies a surcharge, calculated according to a certain percentage, variable from municipality to municipality, on the amount paid as corporate income tax, which cannot exceed 10% of the latter. As corporate income tax is generally charged at the 25% rate, the two taxes together could be as high as 27.5%.

In the wake of the entry into force of the 2007 State Budget Law, the local finance law changed the rules for determining the aforementioned surcharge. It will no longer be charged on the corporate income tax but on the taxable income. Thus, the effective rate of taxation on annual company profits will decrease from 27.5% to 26.5%.

Tax is due on an annual basis and is determined according to a self-assessment system. Throughout the year, though, some of the tax due is withheld at source and special payments on account might also be due. Both the amounts withheld at source and the payments on account are taken into consideration when determining the final tax amount due at the end of each year.

There are also several mechanisms to avoid the economic double taxation of profits and international double taxation: treatment as a non-taxable person or the deduction from the taxable profit of some amounts are some examples.

Corporate income tax benefits are mainly related to investment and were reduced in the 2007 State Budget Law, in line with the general corporate income tax rate.

The State Budget Law for 2007 made some major changes concerning corporate taxation and tax benefits. As a result, the minimum direct holding of a non-resident company in the share capital of a Portuguese company, which is necessary to trigger the withholding exemption, has been reduced from 20% to 15%, in cases in which the company meets the conditions laid down by the parent companies and subsidiaries directive.

Moreover, as far as the special taxation system for groups of companies

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is concerned, the reference to the validity of this special system for five accounting periods has been eliminated. The new wording is limited to creating an obligation to communicate the use of this special taxation system, which will be implemented by the controlling company, to the Treasury Department director-general, and makes no reference to its duration.

In the wake of the agreement entered into by the EU and Switzerland, the profits that a company resident in Portugal makes available to a company resident in Switzerland are exempt from corporate income tax, subject to the terms and conditions provided for in the agreement entered into between the EC and the Helvetic Confederation. This is provided that the beneficiary of the profits has had a direct minimum holding of 25% of the share capital of the company which distributed the profits for at least two years previously, in accordance with the conventions aimed at avoiding double taxation entered into by Portugal and Switzerland with third states; and that neither entity has its tax domicile in such a third state and both entities are liable for corporate income tax, do not benefit from any exemption and both are limited liability companies.

The new law also implements a mechanism which allows the elimination of double economic taxation on profits distributed to entities resident in Portugal by affiliated companies resident in African countries of Portuguese official language, provided that the following conditions are met:

- the beneficiary of the profits is liable for, and not exempt from, corporate income tax and the affiliated company is liable for, and not exempt from, income tax similar to corporate income tax;
- the beneficiary has directly held a share of at least 25% in the capital of the affiliated company for over two years;
- the distributed profits derive from the profits of the affiliated company which have been taxed at a rate of not less than 10% and do not derive from activities which generate passive income such as royalties, capital gains and other securities-related income, income from property situated outside the company's country of residence, income from the insurance sector derived predominantly from insurance of assets located outside the residence country of the company, or insurance in respect of people who do not reside in that territory and income from banking transactions which are not directed mainly at the market of that territory.

THE CORPORATE INCOME TAX RATE HAS FALLEN SIGNIFICANTLY, SIMILAR TO WHAT HAS HAPPENED IN OTHER EU COUNTRIES

Benefits relating to the interior of the country (less developed regions) are now laid down in the Tax Benefit Statute. Companies which are engaged in activities in the agricultural, commercial or industrial sectors in the interior will be granted certain tax benefits, namely: reduction of the corporate income tax rate to 20%, reduction of the corporate income tax rate to 15%, for new companies during the first five years; an additional 30% of the depreciation and amortisation of investment expenses of up to €500,000 (£336,000) except for lands and passenger vehicles may be taken into account in the assessment of the taxable base; an additional 50% of the compulsory social security costs in respect of the net creation of jobs for an indefinite period of time (labour contracts for an undefined term) may be taken into account in the assessment of the taxable house.

The special tax regime for the reorganisation of companies with a concentration or co-operation element is now laid down in the tax benefit statute. These tax benefits cover companies whose registered office, effective management or domicile is located in Portugal or in another member state of the EU, or in a country which has a double tax convention in force with Portugal regarding income and capital, save for entities domiciled in tax havens. The benefits are the following: exemption from municipal property transfer tax on the transfer of property necessary for the concentration or co-operation; exemption from stamp duty on the transfer of property, incorporation, increase of capital or of assets of a capital company necessary for the concentration or co-operation and exemption from fees and other charges due for executing the legal acts required to execute the concentration or co-operation.

Finally, a re-evaluation of the tax benefits has been carried out and most be enhanced and the non-structural tax benefits are granted for no longer than five years, which means that periodically the reasons for granting them must be reassessed.

Due to international tax competition, the corporate income tax rate has fallen significantly, similar to what has happened in other EU countries. Therefore, the Government has gradually sought other sources of tax revenue, such as local taxes, which already in 2007 has been the object of a new law on local tax and has been heavily reliant on increasing oil tax and VAT revenues.

This year will also be the year of the motor vehicles taxation reform. In line with the position held by the European Commission, motor vehicles taxation shall increase according to vehicle circulation and carbon dioxide emissions will be taken into account when establishing the tax amount due. Biofuels and other renewable fuels will also be considered at the oil tax level.

The Government has also adopted several anti-abusive measures to fight tax evasion, along with modernising and increasing the efficiency of the Treasury Department, in order to reduce the Portuguese budgetary deficit. ■

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