

THE PORTUGUESE PERSONAL INCOME TAX (IRS) REFORM: FAMILY, MOBILITY AND TAX SIMPLIFICATION



TAX & BUSINESS



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1. INTRODUCTION

On the last of 18th July, the Commission for the Personal Income Tax (hereinafter IRS) Reform presented the preliminary draft of the IRS Reform. The preliminary draft has as its main objectives; in accordance with the Commission's mandate:

- (i) the tax simplification, in particular regarding the reporting obligations regime;
- (ii) the social mobility, in order to enhance the merit and effort, upon the evaluation of the taxation that relies on employment income, and;
- (iii) the family protection, by taking into account the importance of birth-rate and by strengthening family tax policies, in order to contribute to the inversion of the demographic deficit in Portuguese society.

Among the many changes that the preliminary draft proposes for the IRS Reform, we intend to divulge, those that we consider to be the main and most innovative measures.

2. SIMPLIFICATION

2.1 The enlargement of the reporting obligation exoneration

As the main measure towards the simplification of the reporting obligations,

notwithstanding other important measures, the IRS Commission proposes the exoneration from the tax declaration submission obligation for the taxpayers that obtain the following income:

- Income subject to final withholding tax, when the taxpayer did not for its aggregation to the remaining income;
- Employment Income or pension income, when the annual amount is equal or lower than € 8,150 (replacing the existing limit of only € 4,104).
- Subsidies granted under the Common Agricultural Policy (CAP), corresponding to an annual value lower than 4 times the social support index (known as "IAS"), as long as the taxpayers also receive isolated on cumulatively € 4,104 of employment or pension income.

However, the above referred exoneration shall not be applied if the taxpayer opts for joint taxation, or obtains temporary rents or annuities that are not destined to the payment of certain pensions, and/or obtains income that was not previously subject to withholding tax, except, in this last case, if the taxpayer asks to the paying entities to withhold the tax.

2.2 The standardization of the deadlines for the submission of the IRS declarations

The Commission proposes the elimination of distinct deadlines for the submission of IRS declarations, depending on whether the submission is made in paper or by electronic means, mainly due to the strong adherence of taxpayers to the submission of such declaration through the internet. The Commission also proposes the extension of such deadline up to the 31st of December of each year, for taxpayers who obtained income abroad and are entitled to a double taxation, and the source state did not assess the tax due yet. However, the IRS Commission also extends the period during which the taxpayers should keep their records and support documents, from 10 to 12 years.

3. CONSIDERATION OF THE FAMILY

3.1 The separate taxation of spouses regime

It is suggested that the existing discrimination in the current IRS regime, in which the option for separate taxation is only provided for unmarried couples living together, should be eliminated. For such purpose, the Commission proposes that the IRS should be assessed individually, by each taxpayer, regardless of their marital status. Therefore, the rule will be the separate taxation for spouses,

meaning that each taxpayer will have to disclose its own income and, only, 50% of their dependents' income. However, married or unmarried taxpayers (in this last case, as long as they are living together) will still be able to opt for joint taxation.

3.2 The family quotient

The Commission proposes that, in addition to the division of the taxable income for two, under the terms of the marital quotient, it should also be made an adjustment depending on the number of dependents.

Thus, the Commission proposes that the taxable income is adjusted by the family quotient, determined according to the tax regime and the number of dependents, considering that to each taxpayer will be granted the factor 1 and, to each dependent, the factor 0,3 (which will be 0,15, in case of dependents considered into two separate declarations, when the spouses or couples living together do not opt for joint taxation). The reduction in the collection by considering dependents through the family quotient is limited to (i) € 750.00 per each taxpayer, in cases of separate taxation, (ii) € 1500.00 per family aggregate that opts for joint taxation and

(iii) € 800 per taxpayer from a single parent family aggregate.

3.3 The Increase of personal deductions based on the members of the family aggregate and the "school ticket"

The IRS Commission proposes deductions with fixed values, applicable regardless of the actual proof of expenses incurred and which will be measured against the number of members of the family aggregate and not, as in the present, according to the family aggregate considered as a whole. The establishment of a global deduction per member of the family aggregate will incorporate personal allowances, health expenses, training expenses, education expenses, expenses with homes for the elderly and expenses incurred for habitation purposes.

The establishment of deductions "per capita" of a fixed value will allow the elimination of communication obligations related, for example, to the expenses paid by the taxpayers with health or habitation. Moreover, the Commission proposes the possibility for employers to pay part of their employees' salaries with social education vouchers, which will be excluded from IRS and may be used for payment of services and school supplies for their children.

4. SOCIAL MOBILITY

4.1 Employment Income

The IRS Commission sustains the amounts allocated as compensation for the transfer of residence due to the change of the usual place where the work is rendered, should be excluded from taxation within the employment income category.

Furthermore, the Commission intends to release specific employment situations from reporting obligations, with the purpose to make the integration into the labour market easier. Regarding the professional and commercial income category, the Commission proposes, amongst other changes, a reduction of the taxation over the entrepreneurs who begin their activity for the first time, under the simplified regime. In addition, the Commission believes that, after the required conditions are met, it is of the utmost importance to progressively eliminate the currently existing surcharge, applied on earnings derived from employment income, professional and commercial income and pensions, as well as the progressive elimination of the additional solidarity surcharge.

4.2 Withholding tax

Another measure proposed by the Commission is the simplification of the withholding system, which should begin with the incorporation of the withholding tax rules, foreseen in the Decree-Law n.º 42/91 of 22 January, within the IRS Code. The Commission's aim is, not only to achieve a merely formal change, but also to delimitate the administrative intervention in this matter.

4.3 Capital Income and Capital Gains

Given that the capital income category currently covers a range of income, whose nature is closer to the capital gains regime, the Commission considers necessary to restructure the incidence rules of both categories, in order to correct the above mentioned imbalances and to ensure, in this sense, a fairer taxation. This proximity to the capital gains regime is mainly due to the fact that obtaining such income leads to the extinction of its generating source. Given the above, the IRS Commission proposes that the income deriving from the following operations should be taxed according to the capital gains regime:

- Repayment of bonds and other debt securities;

- Redemption of investment funds units and the liquidation of these funds;
- Credit Assignments;
- Transfer of supplementary and ancillary contributions;
- Liquidation of fiduciary structures, namely "Truts", in favour of the Settlor.

The Commission also proposes the uniformization of the tax rate applicable to income deriving from both mentioned categories, to 28%, applicable to both resident and non-resident taxpayers.

4.4 The Approach of pensions to employment income

The Commission proposes, as well, the uniformization of the taxation rules applicable to the categories of employment income and pensions. The alleged reason is that both categories are composed of income of similar nature. Although the Commission intends to achieve this harmonization of the mentioned taxation regimes, the Commission opts for a non-formal integration of both categories. Furthermore, the Commission proposes the maintenance of the specific deduction for the pension's category of € 4104, allowing the deduction of the contributions

for social protection schemes and for health legal systems, in the exceeding amount.

Finally, the Commission proposes the revocation of the existing progressive regressivity of the specific deduction for gross pension income, when the annual value exceeds € 22,500, per taxpayer.

4.5 Rental income

Rental income is also subject to major changes, due to the increasing use of rented housing. The current regime establishes an overtaxation of this type of income, not only due to the fact that buildings are subject to the IMI and, cumulatively, the rents are subject to IRS, but also due to the reduced tax consideration of expenses incurred within this economic activity. Further to the analysis of these aspects, the IRS Commission proposes to add to the professional and commercial income category, the income that arises from the repeated practice of renting properties, as the main economic activity of a taxpayer. It also foresees an extension of the tax expense deductions that are effectively incurred and paid by the taxpayer to obtain or ensure such income.

5. RESIDENCE

5.1 Partial Tax residence

The IRS Commission also proposes, in order to adjust the regime to situations, constantly growing in a globalized world, where there is a change of residence during the tax year by admitting partial tax residence situations. This measure aims to end with the complexity of some situations deriving from the current regime, which does not allow to consider simultaneously a taxpayer, as a resident and a non-resident in the same fiscal year. With this amendment, it will be possible for a taxpayer in the year, in which he changes his residency to another State, becomes tax resident in such State as from the date in which he actually became resident in that State's territory. On the other hand, the taxpayer who moved away to become resident in another State will quality as tax resident until the date of his departure. In addition, this amendment allows the portuguese tax regime to adjust to the OECD tax policy.

5.2 Separate analysis of each family aggregate member

With respect to tax residency, the Commission also proposes that it should be considered, in the future, separately,

for each family aggregate member. Thus, the qualification of each family aggregate member`s tax residency will be more harmonized with the current family dynamics.

6. DELIMITATION OF THE INDIRECT EVALUATION REGIME AND OF THE WEALTH SIGNS REGIME

The IRS Commission intends to strengthen the taxpayers` guarantees, namely, through a more thorough delimitation of the applicability of the indirect evaluation regime, establishing more demanding criteria to allow corrections to income or expenditure.

To this end, the Commission abandons the previous “income standard” system, as it considers that this system is not sufficient towards the various possibilities through which the income deviations.

Moreover, the Commission reinforces the taxpayer`s defence means, allowing the taxpayer who has not appealed against the evaluation decision, to oppose to the assumptions and the quantification of the indirect evaluation, by submitting an administrative claim or a judicial appeal against the assessment act.

Finally, the IRS Commission intends to eliminate the special tax rate of 60% applicable to these accruals.

7. CONCLUSION

In case these changes are approved, they will take effect as from the 1st of January, 2015.

The IRS Reform shall allow to achieve greater justice, efficiency and equity in the taxation of individual taxpayers, making it simpler and easier to understand and to comply with.

Simultaneously, the Commission wanted to leave, for the future, some deeper changes, in order to not jeopardize international commitments and the growing confidence in the tax stability that Portugal intends to achieve in the international markets, which derives in a pressing and necessary rigorous quantification of the implications that the Reform will have in tax revenue.

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