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To help curb the expected budget deficit for 2005, the Portuguese parliament has approved changes to the 2005 budget bill, including measures that will increase the tax burden on companies and individuals. (For prior coverage, see *Tax Notes Int'l*, May 30, 2005, p. 748.)

The changes — approved July 6 — include measures to crack down on tax evasion, reinforce tax efficiency, and amend several taxes, including the personal income tax, the corporate income tax, the VAT, and the stamp duty.

Antiavoidance Measures and Income Taxes

The revised budget bill authorizes the government to amend the tax regime applicable to dividend distributions to prevent dividend stripping. It provides for measures that are designed to fight dividend stripping by any operation entered into by entities that are subject to taxation and entities that, on whatever grounds, are tax-exempt or subject to a more favorable tax regime. It authorizes the government to introduce a similar withholding tax rate (which cannot exceed 25 percent) for dividend distributions to both resident and nonresident individuals and companies, and to eliminate the withholding tax exemption on dividend distributions related to shares that are held for less than one year.

In connection with the personal income tax, the revised budget bill introduces some amendments related to capital gains and international tax credit rules. Previously, capital gains obtained by individuals from the sale of shares in a stock corporation were not subject to tax, provided the individual shareholder had held the shares for more than 12 months. Under the new rules, those capital gains will be subject to tax if the corporation involved in the transaction owns real property that represents more than 50 percent of its assets.

The general international tax credit rule is that resident entities must include in their taxable base any gross income arising abroad. Taxes paid abroad by a resident individual or company on its foreign-source income may be credited against the taxpayer's tax liability on its total income, subject to the ordinary credit system. Under the amendments introduced on July 6, that credit, calculated on a per-country basis, is limited to the lower of the foreign income tax actually paid, or the Portuguese income tax that would be due on that portion of the income if no credit were granted, after the deduction of all costs, losses, and expenses directly or indirectly related to the income received (for companies), or after the deduction of specific deductions made in accordance with the individual income tax (for individuals). Also, unused credit no longer may be carried forward for five tax years, as was previously the case.

These amendments introduce a distortion in the international tax credit rules that will affect taxpayers' ability to benefit from unilateral relief from double taxation of income.

As far as corporate income tax is concerned, the revised budget bill limits benefits related to loss deductions. From now on, any operating losses incurred by a Portuguese resident company may not be carried forward for the subsequent six years if more than 50 percent of the shareholding or voting rights of the company has changed. The 2006 budget bill is expected to introduce more limitations on corporate tax benefits.

One-Time Tax Amnesty

The revised budget bill also introduces an extraordinary regime for the repatriation of certain assets not located in Portugal as of December 31, 2004 — namely, bank deposits, securities, and other financial instruments, including life insurance policies related to investment funds and to capitalization operations. Under the new regime, Portuguese resident individuals will be taxed at a rate of 5 percent on the value of repatriated assets. That rate can be reduced to 2.5 percent if the assets are reinvested in bonds issued by the Portuguese Republic. Also, all tax and criminal liabilities related to the assets are nullified, unless an inspection has already been initiated in relation to the same assets. The regime does not cover assets located in countries or territories identified as uncooperative tax havens by the OECD Committee on Fiscal Affairs.

EU Savings Tax Directive

The new repatriation regime is particularly relevant, considering that the EU savings tax directive (Council Directive 2003/48/EC of June 3, 2003) entered into force on July 1. According to the directive, interest on foreign bank accounts and other types of financial instruments held by EU resident taxpayers will be subject to an exchange-of-information regime or, as an alternative, the source country may withhold tax on that income. Some countries, including Portugal, will maintain withholding tax at source and also will implement the directive's exchange-of-information regime.

The revised budget bill also amends Decree Law 62/2005 of March 11, 2005, which implemented the savings tax directive by extending its scope to countries or territories such as Anguilla, the Netherlands Antilles, Aruba, the Cayman Islands, Guernsey, Jersey, the Isle of Man, Montserrat, the Turks and Caicos Islands, and the British Virgin Islands, and revoking Portugal's bank secrecy regime.

VAT Amendments

The revised budget bill also amends the rules governing the right to deduct VAT. Previously, a taxable person could deduct input VAT only within one year of the date the taxable event occurred. However, a taxable person could always submit a petition to the Directorate General for Contributions and Taxes, seeking special authorization to deduct input VAT for a period of up to four years from the moment of the taxable event. Under the amendments introduced in the revised budget bill, the normal period for deducting VAT has been extended to two years, but a taxable person no longer may request special authorization to deduct VAT during a four-year period. It is important to note that at the end of June, the parliament approved an increase in the general VAT rate, from 19 percent to 21 percent.

The parliament has also authorized the government to introduce some antiavoidance rules to combat real estate transactions that are used solely to avoid or reduce VAT liability. The government is entitled to amend the VAT Code by introducing the concept of market value, and to review the regime applicable to waive the right of exemption on property transactions involving related parties.

Stamp Duties

The revised budget bill subjects monetary donations made to individuals to stamp duty at a rate of 10 percent. (Those types of donations formerly were tax-exempt.) ◆

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