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Portugal Approves First Stage of Wealth Tax Reform

by Francisco de Sousa da Câmara and Nuno de Oliveira Garcia

The Portuguese Parliament on 8 May approved the government's proposal to enact the first step of the long-awaited wealth tax reform. Following much discussion in recent years, the proposed reform would be implemented progressively. (For prior coverage, see *Tax Notes Int'l*, 14 Apr. 2003, p. 120, *2003 WTD 67-1*, or *Doc 2003-8841 (1 original page)*.)

The first wave of reform would apply to real estate taxation, namely the municipal transfer tax (*sisa*). The new bill states that *sisa* general tax rates would be reduced from 10 percent to 6 percent for urban real estate, and from 8 percent to 5 percent for rural real estate, in June.

Other developments, such as the replacement of the current *sisa* and the annual local real estate tax (CA) and the abolition of the gift and inheritance tax (ISD), are already scheduled for the beginning of 2004. For now, the local motor vehicle tax (IMSV) is still under consideration, but global proposals on a wealth tax on the possession of works of art, household furnishings, and personal belongings (including cash and securities) are not under discussion for the time being.

Background

Since 1989 there have been three main property taxes in Portugal: *sisa*, an ancient tax levied on the transfer for consideration of ownership rights or partial ownerships in real estate; the CA, a municipal tax levied on the net worth of property situated within the territory of each municipality; and the ISD, levied on the transfer, free of charge, of immovable (real estate) and movable property.

In the early 1990s, politicians, tax law professors, and lawyers shared the opinion that the taxation of immovable property in Portugal suffered from a series of problems. Nonobjective valuations, together with unrealistic outdated values of the properties and high tax rates, contributed to the appearance of not only unfair taxation but also increasing tax evasion. The crux of the problem rested on the fact that while owners of new houses were paying realistic prices based on the recent or current market value of their houses, owners of old houses — notwithstanding their location, size, or luxury finishings — were paying tax based on the first evaluation of the house, which in some cases resulted in ridiculous amounts. Consequently, tax revenue from property taxation in Portugal was significantly lower than in the rest of the OECD countries: In 1993 the public tax revenue from property taxation represented 2.4 percent of all public tax income, despite the fact that the OECD's average was 5.7 percent. Even today the annual revenue of the CA is a relatively insignificant €600 million (less than 1 percent of the Portuguese GNP).

To combat the problems, several government commissions studied and prepared drafts and projects for the long-anticipated wealth tax reform. Some projects suggested the replacement of current property taxes with a single wealth tax, while others recommended the application of VAT on the real estate transfer, following the example of other European countries. Alternative projects proposed minor changes to the CA, mainly defending the introduction of new methods for the assessment of the taxable amount and the urgent update of properties value.

The 2003-2004 wealth tax reform provides for the necessary replacement of *sisa* and the CA with two

new taxes, alongside the abolition of the ISD. The main goals are to simplify legal procedures, to fight against tax evasion, and to increase the tax base.

New *Sisa* Rates

For now, the Portuguese Parliament only approved the replacement *sisa* rates. The tax rates would be significantly reduced and would progressively range as follows:

- for habitation purposes, from a full exemption (for transfer of properties with a value that does not exceed €80,000), to 2 percent (for transfers of properties with a value up to €110,000), to a general rate of 6 percent (for transfers of properties with a value higher than €500,000);
- 5 percent (currently 8 percent) for the transfer of offices, trading, industry, and nonurban purposes, and 6.5 percent (currently 10 percent) for other cases; and
- 15 percent for the transfer of real estate owned by nonresident companies incorporated in low-tax jurisdictions, as an antiavoidance rule.

For now, the tax base will still be the value for which the property in question is transferred, taking into consideration the conventional value, unless the value of the real estate as shown in the register at the date of tax assessment is higher.

Facing urgent problems due to the stagnation of the real estate market and tax evasion (namely tax simulation or fraud regarding the conventional value of real estate sale and purchase agreements), the government intends to enact the new tax rates this month. This haste has been provoked by criticism from the construction and real estate industries, which claim that the already stagnant real estate market would be plunged into additional disarray as potential buyers postpone their purchases until 1 January 2004.

New Municipal Transfer Tax

For the next few months the Portuguese Parliament is expected to approve regulations for the replacement of *sisa* with the new municipal tax on the transfer for consideration on real estate (IMI). Changes are not on a full scale because the taxable person, under the IMI rules, would continue to be the person who acquires the property. However, the tax base, to prevent fiscal simulation, is expected to be the conventional value only if it is higher than the actual value of the building determined according to the new IMI rules (see below).

New Municipal Tax on Real Estate

Also in the next few months the Portuguese Parliament is expected to approve regulations for the replacement of the current CA with the IMI starting 1 January 2004. In this context, few — but important — changes are foreseen.

Older real estate would be revalued according to monetary devaluation coefficients and to different indexes related with the location of the property within the Portuguese territory. New urban real estate would be valued according to objective rules such as: (1) the construction price of the building; (2) the inside area square footage; (3) the location; (4) the quality and comfort level; and (5) the age of the construction.

The value of rural properties would, in principle, be determined by multiplying the rural income by a factor of 20.

The enforcement of the new municipal tax, previously the sole responsibility of the local tax department, would now be conceded to city and town halls, which would be granted the authority to evaluate the properties and decide on tax benefits.

As a result of the revaluation of the property values, the government announced that instead of the 0.7 percent to 1.3 percent rate range provided under the current CA, the tax rates of the new IMI would range as follows: from 0.2 percent of the value up to 0.5 percent for new urban real estate; from 0.4 percent up to 0.8 percent for old urban real estate; a flat rate of 0.8 percent for rural properties; and 5 percent, as an antiavoidance measure, for real estate owned by nonresident companies incorporated in low-tax jurisdictions.

Even with lower rates, the revaluation of the property values would show that from 2004 on, property taxes will no longer be a sideline. Currently, interest payments have fallen more than property values have risen. The increase of the burden for 2004 is limited to €60, but the taxpayer should be prepared for additional increases in the following years.

Notwithstanding these modifications, the IMI is expected to be very similar to the CA, maintaining several of its main characteristics. Following the CA, the IMI would carry on as a municipal tax levied on the ad valorem basis of the property, with it being incumbent on the competent municipality to define the applicable rate annually. The taxable person would still be the owner, the usufructuary, or the party having the use or fruition of the property on 31 December of the year to which the tax relates.

Although there is a general consensus as to the positive changes the IMI will bring, some analysts argue that the single objective rule of the inside area of a property for valuation is the only practical

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solution for the already heavily overburdened Portuguese tax authorities, as more than 2 million houses out of a total of more than 6.5 million urban properties are valued below €250.

Meanwhile, issues such as penalty taxation for unoccupied houses or the possibility of municipalities with a large population adopting higher basic rates are sidelined.

Gift and Inheritance Tax and Stamp Duties

In terms of the ISD, the Parliament is also expected to approve its abolition from January 2004. In consequence, all transfers free of consideration would pay stamp duty of 10 percent. Nevertheless, transfers to spouses, descendants, and ascendants would be tax-exempt.

Under the proposed reform, dividend distributions by companies with their head office in Portugal, and funded public debt bonds/certificates and debentures or bonds issued by any other public or private entity, would no longer be taxed by the current 5 percent substitute gift and inheritance tax (ISDA), on payment as a lump sum. Not long ago, the ECJ sustained that the collection of this tax within EC parent and subsidiary companies violates the Parent- Subsidiary Directive (see *Epson* case; for related coverage, see *Tax Notes Int'l*, 24 July 2000, p. 323, *2000 WTD 136- 1*, or *Doc 2000-19040 (3 original pages)*). New rules to assess the value of companies' stakes, shares, and securities in general, for transfer purposes, are also expected.

Conclusion

This first stage of reform sets out mostly minor changes to the current real estate taxation legal provisions, namely in relation to the transfer of properties. However, significant changes in the behavior of all economic agents operating in the real estate market are expected. This first step of reform, together with the new municipal tax on real estate expected in 2004 and the promise of a new, more liberal regime for house rentals, may well be the necessary catalyst for vigorous competition in the Portuguese real estate market. It will be absolutely necessary, however, to implement the rules that will make it possible to determine the actual value of buildings. ◆

♦ *Francisco de Sousa da Câmara and Nuno de Oliveira Garcia are with Morais Leitão, J. Galvão Teles & Associados in Lisbon.*

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