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Portugal: 2002 Year in Review

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Few, if any, legal provisions change as much as those that relate to tax legislation. Every year several aspects of the tax system are amended, and those changes are not confined to the budget bill. Goals range from adapting new economic and financial policies and closing loopholes, to updating the system to conform with the dominant policies and lobbies. In fact, the traditional definition of taxation as "an individual sacrifice for a collective goal" is constantly refreshed and reinterpreted.

Portugal is a prime example of that propensity to change. However, many economic sectors — and the government itself, it seems — understand that some stability is required. Things change so much that even the tax professionals — from the tax authorities to the judges, including tax policy advisors — face extreme difficulties in keeping themselves up to date.

Recognizing that situation, the government at the end of 2002 decided to increase the economy's competitive edge while ruling out the adoption of immediate tax reforms in areas such as real estate taxation, wealth tax, or vehicle taxation, which have been the subject of much discussion in recent years. Those promises, together with a pledge to fight tax evasion, are the goals of the 2003 budget bill, which was recently approved by the Portuguese Parliament. The bill also aims at reaching Portugal's overall financial objective — reducing the public deficit in accordance with the EU Stability and Growth Pact. Some of the more relevant measures that were adopted in 2002 are illustrated below.

Transfer Pricing

New provisions that significantly change Portugal's transfer pricing system came into force on 1 January. The new regulations follow the OECD Transfer Price Guidelines regarding the evaluation methods and the regulation of cost contribution agreements. Both have been extensively regulated by the Ministry of Finance decree 1446-C/2001 of 21 December 2001.

The new system, however, attracted some criticism. The definition of "related party" introduced a whole new range of problems. It was also perceived as overbroad and, in some ways, vague. The new law also places a much greater burden on taxpayers to maintain an extensive file on each transaction or series of transactions falling within the related-party concept.

Although the Tax Commission previously recommended creating procedures to negotiate advance pricing agreements with tax authorities, no APA guidelines were issued.

Although the new legislation creates more certainty in specific areas (such as the adoption of the OECD methodologies), it raises questions regarding the qualification of related parties and the standard of documentation that will satisfy the tax inspectors.

Electronic Invoicing

The tax form to request authorization from the General Tax Directorate to use electronic invoices was published at the beginning of 2002. Several multinational companies prepared to initiate the use of that invoicing system, but during the course of the year a quid pro quo between the EU Commission and Portugal delayed the authorization process. Taxpayers continue to wait for a green light to start using the electronic invoices upon request. That is expected to happen in 2003.

E-Commerce

On 7 May the EU Council passed Directive 2002/38/EC and Regulation EC 792/2002 under which non-EU vendors will be required to collect VAT on electronically supplied services purchased by non-business EU residents.

Therefore, a non-EU vendor that sells electronic or digital supplies within the EU will be required to register for VAT.

However, a non-EU vendor may avoid the uncertainty and complex VAT compliance regime established by the Directive by setting up either a subsidiary or a branch within an EC member state and receiving similar VAT treatment as its EU counterparts, which charge VAT on sales to EU nonbusiness customers on an origin basis.

Madeira Island, an autonomous region of Portugal with a well-run International Business Centre and the lowest VAT rate in the EU (13 percent), presents itself as the jurisdiction of choice for non-EU vendors to establish a subsidiary or branch and, thus, benefit from a similar VAT treatment as its EU-based counterparts registered for VAT.

Because VAT rates vary within the EU between Sweden's 25 percent and Madeira's 13 percent, non-EU vendors (of digital products such as software, computer games, data, publications, music, videos, and fee-based broadcasting services) may arbitrage across different tax rates and achieve a fiscal benefit of up to 13 percent, if registered for VAT through a subsidiary or branch in Madeira — and, by extension, Portugal.

Adopting the Euro

The preparations for the euro that took place before 2002 allowed Portugal's financial systems to operate without problems. New measures were also adopted this year, but by the end of the year no major financial, tax, or accounting problems had arisen with the euro's introduction. The tax authorities have displayed a willingness to abide by the spirit of the EU principle of "no prohibition, no compulsion," ensuring that within the practical limits of administrative capacity, prohibitions were minimized to the fullest possible extent.

Tax Treaties

Tax treaties with Denmark, Iceland, Malta, and Ukraine entered into force in 2002.

Foreign Tax Policy Objectives

Just before the government changed in March 2002, the former secretary of state for fiscal affairs published his views on Portuguese foreign tax policy, focusing on:

- the EC tax package in its three elements: the proposal for a Council Directive to ensure effective taxation of interest income from cross-border investment of savings that is paid to individuals within the EU; code of conduct for business taxation; and the Commission's March 1998 proposal for a Council Directive to eliminate withholding taxes on payments of interest and royalties made between associated companies of different member states;
- tax treaties;
- simplification and modernization of VAT;
- taxation of e-commerce;
- state tax assistance;
- the OECD Forum on harmful tax competition;
- administrative cooperation and international mutual assistance; and
- energy and vehicle taxation, as well as the EC regime regarding excises.

Although interesting, the change of government raises questions as to the way in which the goals were selected and defined in that document.

Anti-Tax-Evasion Measure

Portugal's Parliament has authorized the government to enact legislation to fight tax evasion resulting from tax arbitrage techniques commonly referred to as bond washing and dividend stripping, specifically through cross-border transactions.

Capital Gains Obtained by Individuals

Regardless of their place of residence, individuals who realize gains with the transfer of shares held for more than 12 months are tax-exempt on their disposal as of 1 January 2003. Capital gains obtained by individuals with the sale of bonds and other debt securities are also exempt from tax. Speculative gains realized by individuals with shares held for less than 12 months are subject to a tax rate of 10 percent.

As a rule, capital gains obtained with the sale of securities by nonresident individuals and companies without a PE in Portugal to whom those could be attributed are also tax-exempt.

Looking Forward

The government's intention to promote investment is demonstrated by the suspension of an existing tax regime favorable to reorganizations and the introduction of a new favorable tax regime to encourage exports in the 2003 budget bill.

Relationships between related parties would come under strong scrutiny not only for transfer pricing controls, but to ensure that tax losses generated with the sale of shares are not registered in a particularly low period for the capital markets. Rearrangements within groups just to create tax losses will be prevented or at least made more difficult. ◆

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