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New Government Proposes Amendment to Budget Bill

by Francisco de Sousa da Câmara

Portugal's new government on 5 May approved an amendment to the 2002 Budget Bill and has submitted it to the Parliament. Basically, the new Executive Branch intends to cut public expenses (about €2.12 million) until the end of 2002 in an effort to achieve a public deficit of 2.8 percent or 2.9 percent. Several measures have been adopted to reduce public expenses, including the dissolution of several public institutes and other organizations. However, the economy is not expected to grow by more than 1 to 1.5 percent.

The "fiscal shock" tax cuts promised by the new government during the election campaign will be postponed. The government's main promise was to reduce the corporate income tax rate to 20 percent, and an individual income tax reduction also was announced. (For prior coverage, see *2002 WTD 51-16*; and *Tax Notes Int'l*, 25 Mar. 2002, p. 1298 or *2002 WTD 53-14*.) However, the precarious state of Portugal's public finances has forced the government to backtrack.

Moreover, the government plans to increase consumption taxes. It has proposed increasing the VAT rate from 17 percent to 19 percent, although some goods will not be subject to the increase. In the archipelagos of Madeira and the Azores, the VAT rates will be 4 percent, 8 percent, and 13 percent (the normal rate). It remains to be seen how strong the impact on inflation will be.

The Socialist Party is alleging that the coalition Socialist Democratic Party/Popular Party government misled taxpayers by promising tax cuts, but increasing taxes instead. The new VAT rate would be particularly hard on the poorest classes, it says.

The tax reform envisaged by the new government still is something of a mystery, but the government recently indicated that the first steps will be new capital gains tax reductions for shares quoted on the stock exchange, combined with measures to fight tax evasion. On 2 May, the Cabinet proposed a new law to reduce the final tax rate for capital gains derived from sales of listed shares to 10 percent and to exempt capital gains from sales of shares held for more than 12 months.

Investment fund taxation also will become more attractive, and observers expect that interest from bonds owned by nonresidents without permanent establishments in Portugal also will be exempt from withholding tax, provided that certain requirements are met.

On the other hand, the government has proposed new provisions to fight tax evasion. Individuals would be authorized to deduct part of the VAT paid with their private expenses (for example, VAT on restaurant invoices and home repairs), up to a tax credit of €50. No new tax incentives would be granted, and existing incentives would be cancelled for taxpayers convicted of tax crimes and for those who fail to pay their taxes on time without justification (claims or appeals). Several other measures would be created to forbid the laundering of interest and dividends.

In any case, the government program clearly indicates that sectorial policies will be complemented by competitive tax rates. The government program's stated goal is to promote economic activity and to provide more competitive conditions for companies resident in Portugal. The reform also is to help attract foreign investment to Portugal.

Although the main focus now is reduction of the public deficit, it will be difficult to reverse that disturbing economic trend without implementing new tax measures that may increase confidence and attract investors. The government has set a 2004 deadline to implement the new, competitive tax measures. Tax issues addressed in the planned reform include the following:

- the taxation of capital markets will be clarified, so that capital gains obtained by individuals on the transfer of shares will be tax-exempt or will be subject to the former tax rate of 10 percent;
- rates for immovable wealth taxes (for example, the transfer tax on immovables and the municipal tax levied on immovables) will be amended; and
- the corporate income tax rate will be reduced to 20 percent (from 30 percent).

Moreover, the government has promised to:

- fight tax evasion and introduce a more sophisticated tax audit system;
- simplify the claim process, reinforcing taxpayers' rights and guarantees; and
- guarantee more tax justice by ensuring that the legal process is speeded up and that judges have more tax specialization.

The government also has promised to remove tax and administrative obstacles that are preventing company reorganizations, to the detriment of the Portuguese economy.

Some of the proposals cannot be postponed indefinitely — certainly not beyond 2004. Domestic and foreign investors must gain confidence, and investments need to be promoted with new incentives that effectively eliminate double taxation and reduce capital gains taxation.

The government now is preparing the 2003 budget bill, which will be presented this autumn. Although it is unlikely that all the necessary reforms will be introduced at that time, the main framework should be established. Meanwhile, the state has a responsibility to set a good example — namely, by providing tax refunds in a timely manner, even when files are decided in favour of the taxpayer. ◆

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