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2017 Budget: The Backdrop, The Road Ahead, and Beyond

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HIGHLIGHTS

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by Francisco de Sousa da Câmara and Diogo Pinto

With its 2017 budget, the Portuguese government seeks to alleviate the austerity measures that applied to taxpayers by reducing the personal income surtax and increasing the national minimum wage and retirement pensions, while raising indirect taxes and creating new real estate taxes.

The 2017 budget bill was released December 15 after being approved November 29 with the support of the Socialist Party (in government) and their left-wing supporters (the Portuguese Communist Party, the Left Bloc, and the Ecologist Party). The Social Democratic Party and the conservative Popular Party voted against the proposal.

The budget introduces fairly mild changes to the taxation system, mostly in relation to corporate income taxation. Also, it doesn't substantially reduce public expenditure. Though controversial, this allows the government to continue the trajectory of budgetary consolidation with a special emphasis on increasing the incomes of families.

The budget forecasts economic growth of 1.5 percent and a budget deficit below 2 percent, continuing the path initiated in 2016. This year is expected to represent the first time that Portugal terminates the year under the excessive deficit limit of 3 percent of GDP since the execution of the memorandum of understanding on economic policy with the EU, the IMF, and the European Central Bank. 2016 was also marked by the decision of the European Commission to cancel the application of excessive deficit fines applied to Portugal.

Parallel Measures

Apart from the shift from direct to indirect taxes, the government also has adopted as part of the 2017 budget a series of additional tax measures that will collect more taxes in the short term as indicated below.

In parallel and before parliament's approval of the budget bill, the Portuguese government adopted three important tax measures, as follows:

Exchange of Information

Following international commitments (either at the OECD and EU level), the government approved new rules for the automatic exchange of financial information in the field of taxation.

The new regime approved the application of U.S. Foreign Account Tax Compliance Act regulations and transposed the Council Directive 2014/107/EU of December 9, 2014, which introduces a mechanism for reciprocal automatic exchange of information regarding residents in other EU member states, or in other participating jurisdictions, in accordance with the common reporting standard developed by the OECD. The financial institutions that must report information have to register with the Portuguese tax authorities under a new form (Form 53) that was published on December 2, 2016.

Tax Amnesty

A new tax amnesty regime, the Special Program for Reducing Government Debt (PERES), was recently approved allowing taxpayers to regularize their tax debts, increasing collections for the state. The plan gave taxpayers until December 20 to apply for the special regime, which allows them to settle tax and social security debts, avoid paying interest and court and procedural costs, and eventually obtain a reduction of penalties. The regime applies only to existing tax debts (that is, the reporting of undisclosed funds or taxes that were due but were not yet assessed are not covered by the current regime), a departure from previous tax amnesties that allowed the government to collect around €3 billion over the last 12 years.

Unlike previous tax amnesty regimes, this one allowed taxpayers to enter into a payment plan, making it possible to pay outstanding debts in up to 150 monthly installments over a maximum period of 12½ years. For those paying in installments, a proportional reduction in interest payments applies, and the tax enforcement process will be suspended without the need to present a guarantee. However, the most significant incentives (a reduction of 80 percent of interest and costs) exist for upfront payment or payment in installments for up to 36 months.

Revaluation of Assets

The government approved an optional regime for companies to revalue tangible assets used for economic activities, as well as investment properties. This regime allows companies to capitalize themselves but will not bind companies to revaluing assets for accounting tax purposes.

The revaluation of the assets' value will be based on the application of the official monetary devaluation coefficients (that is, the indexation coefficient for the year of revaluation or acquisition) to the value obtained from the previous revaluation or, alternatively, to the acquisition/production value.

The surplus resulting from the revaluation (that is, a "revaluation reserve") will be subject to autonomous taxation at the rate of 14 percent, due in three annual installments payable on December 20 of 2016, 2017, and 2018. In contrast, the taxpayer may increase its tax deductions on future depreciations (including with a plan that allows for depreciating more than 100 percent of the assets' value and making use of an accelerated plan) and will also be allowed to calculate future arising gains and losses using the stepped-up basis resulting from the revaluation.

This regime can be particularly beneficial for taxpayers with undervalued assets and sufficient funds and cash flows to pay the upfront taxes.

Budget Measures

Corporate Income Tax

Generally, financial institutions will benefit from a new tax deduction from 2017. Basically, their taxable income will include negative variations in worth that are not reflected in their net income related to the distribution of income from additional Tier 1 and Tier 2 own funds instruments (meeting the requirements established by EU Regulation No. 575/2013 of the European Parliament and EU Council, dated June 26, 2013). This rule can be applied if the instruments do not attribute to the respective holder the right to receive dividends or voting rights on the general shareholders meeting and are not convertible into capital. If the different criteria are met, this rule intends to include instruments such as nonconvertible perpetual bonds.

After several years of systematic and recurrent changes to the rules concerning carryforward tax losses and the reduction of the carryforward period from 12 to five years, the first-in, first-out method will be abandoned. From now on, corporate taxpayers may choose the losses that they intend to use to offset their profits.

Personal Income Tax

In spite of earlier political announcements, the termination of the personal income surtax was postponed. There will instead be a progressive reduction of the surtax in 2017 that will benefit taxpayers with lower taxable income.

VAT and Other Indirect Taxes

Depending on the taxpayer's choice, the importation VAT regime might become equivalent to the intra-Community acquisition of goods regime. Companies that import goods may opt to not be assessed by the customs office at the time of importation, preferring instead to report it in their periodic VAT declaration (that is, usually assessing and deducting VAT).

This regime will be fully applicable after March 2018 and is expected to apply from September 1, 2017, for the importation of goods foreseen in Annex C of the Portuguese VAT Code, except mineral oils.

Moreover, the government was granted authorization to decrease the VAT rate from 23 percent to 13 percent on some beverages according to a specific list attached to the VAT Code.

The budget extends the scope of the excise duty on alcohol and alcoholic beverages (IABA) to soda drinks, creating what is being called the "fat tax."

The following drinks will become subject to the fat tax: nonalcoholic drinks with added sugar or other sweeteners, such as sodas, energy drinks, and flavored water; and alcoholic beverages with alcohol content between 0.5 and 1.2 percent.

According to the budget law, this measure is designed to decrease the consumption of sugar, especially among children, eventually reducing costs to the public health system. However, opponents argue that the tax is discriminatory, and litigation may arise based on the violation of the equity, justice, and proportionality constitutional principles.

Real Estate Taxes and Stamp Duty

Probably the most widely discussed proposal creates a new "add on" to the municipal real estate tax (IMI).

The IMI add-on will be payable by individuals and corporations that own urban properties licensed for residence or "land for construction" in Portugal. Individuals will not be taxed if the total of their properties' tax value is not higher than €600,000. A tax rate of 0.4 percent will apply to the tax value of all the urban properties owned by corporate taxpayers. Individuals will be subject to a tax rate of 0.7 percent, or 1 percent if their properties are worth more than €1 million.

As an antiavoidance rule, corporate taxpayers may also become subject to a 0.7 percent (for property valued up to €1 million) or 1 percent (for property valued above €1 million) tax rate if the urban property they own is for the use of its shareholders or members of the corporate bodies.

Other urban properties intended for industrial, commercial, or other services were excluded from the IMI add-on after discussions in parliament.

As a consequence of the IMI add-on, the annual 1 percent stamp duty levied on residential real estate and

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land for residential construction with a tax value higher than €1 million has been eliminated.

Enhanced Investment Incentives

The budget bill brings good news for new investments and recapitalizations of companies and start-ups, although all of the incentives are quite limited.

The bill modifies the Investment Tax Code. Specifically, the eligible investment limit of the Tax Scheme for Investment Support (RFAI), which benefits from a rate of 25 percent, will increase to €10 million. Also, the Research and Development Tax Incentives Scheme (SIFIDE) has been amended to assure that expenses for the constitution of ecological projects increase by 10 percent.

The conventional remuneration of the share capital regime has been extended and enhanced. In the future, 7 percent (currently 5 percent) of cash contributions, as well as of conversions of shareholder loans (not possible until now), made upon the incorporation of a company or at the time of any capital increase up to €2 million will be deductible from corporate taxable income. Net financing expenses will be limited to the higher value of €1 million or 25 percent of the result before depreciations, amortizations, net financing expenses, and taxes (this is a reduction from the 30 percent limit for taxpayers not benefiting from this incentive).

Following Portugal's commitment to attract start-up investment, the 2017 budget approved a seed program (Programa Semente) that creates new tax benefits targeted at individuals investing in start-ups. The program will allow a deduction of 25 percent of eligible investment, limited to 40 percent of the personal income tax payable. Capital gains arising from the sale of start-up shares won't be subject to taxation if the realization value is reinvested in the same year or the year following the transmission. The application of this new regime coincides with the reception of the Web Summit that was held in Lisbon in November 2016 and will be held there again in 2017 and 2018.

Medium and Long-Term Objectives

No significant changes have been made to the nonhabitual resident tax regime or to the golden visa regime.

Under the nonhabitual resident tax regime, individuals who qualify as Portuguese tax residents and were not taxed as a resident in Portugal in the five years before qualification will benefit during a 10-year period from a 23.5 percent flat rate on Portuguese-source employment and business income derived from high-added-value activities, as well as the application of the exemption method on several items of foreign-source income, such as pensions, interest, and dividends.

The golden visa regime continues to attract foreign investors from non-EU countries, who are able to obtain a fully valid residency permit in Portugal. This residency permit allows the investor and his family members to enter or live in Portugal and to travel freely within most European countries (Schengen space).

Moreover, no changes have been made to Portugal's arbitration system for settling tax disputes, which is becoming more efficient and thus safeguarding taxpayers' fundamental rights and expediting the resolution of cases against the Portuguese tax administration.

The Tax Arbitration Center (CAAD) offers an alternative approach to conflict resolution for individuals and companies. The vast majority of the arbitral decisions are handled in less than four months (the maximum period is 12 months), making arbitration significantly faster than the judicial court system. Since its creation, nearly 2,000 taxpayers have chosen arbitration. ◆

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