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ABUSIVE TAX SCHEMES

(A BRIEF ANALYSIS OF THE PROPOSED DECREE-LAW)

1. Dashing the somewhat raised hopes of economic agents everywhere – as well as confirming their worst expectations, or so it seems – the Government has finally released the wording of the decree-law bill drafted under the legislative powers conferred by Law 53-A/2006 of 29 December, which enacted the 2007 State Budget, with a view to laying down preventive combat measures against so-called aggressive fiscal planning.

Following the course laid down by the empowering legislation, the central focus of the bill is the imposition of a duty on entities which provide support, consultancy, advisory or similar services to communicate to the Director General of Taxation - with express derogation from any duties of secrecy by which they may be bound - any operations or transactions conducted by their clients where the main objective, or at least one of the objectives, is to obtain tax benefits in respect of IRS (Personal Income Tax), IRC (Corporation Tax), IVA (Value-Added Tax) Municipal Property Tax (IMI), Municipal Property Transfer Tax (IMT) and Stamp Duty (IS), but not of other taxes without express justification.

2. Although the Bill follows the essence of the empowering law, it takes on a more surprising twist when it comes to specifying concepts which are important to its application. Despite the empowering law having stipulated that the range of measures to be taken should be aimed at combating more serious situations, generally those leading to tax evasion and abuses of law – the so-called "aggressive" tax planning - it is obvious that in defining the scope of transactions subject to this statutory duty, the Government has opted for limits which, in practice, will impose a duty to report any and all situations that will bring about less burdensome tax options, whether they be lawful, unlawful, legitimate or non-legitimate.

Thus, according to the bill, a tax planning situation subject to compulsory communication to the Director General of Taxation will include any and all transactions, plans, projects, proposals, advice or instructions which will lead to or it is hoped will lead to obtaining a tax benefit, which for this purpose is deemed to be a reduction, elimination or deferral of the tax or the obtaining of a full or partial tax benefit which could not otherwise be obtained.

3.Furthermore, according to the released text, besides transactions involving entities governed by more privileged tax provisions (such as those resident in the "black list" of tax havens or which are not taxed on income there, entities liable to an actual taxation of less than 60% of the tax that would be due in Portugal as well as exempt entities), any transactions involving financial or insurance operations, regardless of the underlying motive, will always be deemed to be tax planning situations. This measure would appear to be excessive.

Yet this is not the only difficulty raised by the bill. The details of the duty of communication – to be filed using a form currently awaiting the approval of the Minister of Finance by ministerial order, – cover information which is so detailed and comprehensive that compliance with this duty, after the entry into force of the decree-law, would entail an unrealistic addition to administrative and bureaucratic tasks which it would be hard to justify, even in cases of abusive tax planning or tax evasion.

Among the details required for the purposes of this duty is a detailed description of the tax planning, description and nature of the business, company structures, the operations or transactions used, the type and contours of the desired tax benefit, and a statement of the legal basis on which the desired tax benefit may be obtained. While the identity of the client is not included in the duty of communication, in practice, it entails the obligatory disclosure of specific know-how in the field of (lawful) tax planning, thus enabling the tax authorities to develop up-to-date knowledge of loopholes in the tax law which they would otherwise have to obtain on their own.

4. As regards the definition of the subjective scope of the duty of communication, the Bill establishes such a broad formula that credit institutions and other financial institutions, chartered accountants, auditing firms, accountants and other entities which provide accountancy services, legal executives and firms of legal executives, lawyers and law firms - as "promoters of tax planning schemes" - would be subject to the compulsory duty of communication in respect of tax planning transactions.

It is a positive aspect, however, from the perspective of safeguarding the fundamental duty of professional secrecy, that this duty of communication is expressly excluded for lawyers and legal

executives in situations where the tax planning has been uncovered during an "assessment of the legal position of the client, within the boundaries of legal consultation, while defending or representing the client in legal proceedings, or in respect of legal proceedings, including counselling on resorting to or avoiding legal action".

On the other hand, whenever the tax planning "scheme" has not been designed, proposed or divulged by one of the above-mentioned "promoters" or when the promoter is a non-resident, the responsibility for complying with the duty on communication will fall to the taxpayer. This is unlikely to happen and also seems inappropriate as few taxpayers will be inclined to make accusations against themselves.

5. The proposed penalties for breach of the duties set out in the Bill are ranked according to the nature of the offender, which also seems excessive to us, given the lack of definition and the breadth of the duty of communication in specific situations which are easy to foresee.

A failure to communicate a transaction or to do so outside the prescribed time limit is punishable by a fine of between €5,000 and €100,000 when the "promoter" is a company and from €1,000 to €50,000 in the case of an individual. In situations where it is the client who fails to communicate the transaction or does so outside the prescribed time limits, where the duty of communication lies with the client, the fines range from €500 to €80,000 in the case of a company and from €250 to €40,000 in the case of an individual.

6. It is worth noting the inclusion of a transitory provision which will allow the regime to apply to tax planning "in course" – an expression which requires greater clarification - at the time the decree-law comes into force, for a period of two months after the date of entry into force of the ministerial order approving the form to be used for complying with the duties of communication, without which it will not be possible to apply the decree-law in question or to produce the desired effects.

7. In summary, the Bill seeks to place a tighter definition on some of the more vague and indeterminate expressions contained in the empowering legislation, yet in its current form it will require far greater reflection, since it too suffers from the faults of a law-making government which is either unaware of or has turned a blind eye to more recent experiences in such matters in other jurisdictions (such as the UK), fails to provide a remedy for the costs associated with creating exaggerated and imprecise additional obligations, abstains from defining with all due precision and thoroughness transactions which qualify as abusive and are therefore subject to the new duty of information, and overrides professional secrecy in a determined yet inappropriate manner, with sole regard to its own ends. It is therefore very likely to be held to be in violation of the requirements of appropriacy and necessity intrinsic to the constitutional principle of proportionality.

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