TAX INFORMATION

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SPECIAL TAX MEASURES (PEC II)

Law no. 12-A/201, which was published on 30 June, provides for the adoption of measures to increase the main taxes that make the greatest contribution to public revenue. The new law results from the current exceptional economic and financial situation and is expressly driven by the need to reduce the budget deficit provided for in the Programme for Stability and Growth (PEC) 2010-2013. The new law complements the announced cuts in public spending and came into force on 1 July.

1. Personal Income Tax (IRS)

For IRS, as personal income tax is known in Portugal, the tax increase takes the form of a new general table of tax rates that has established an increase of 0.58% in the rates applicable to income up to the third bracket, that is taxable income the annual value of which does not exceed €17 979.00, and of 0.88%, for all other brackets:

New General Table of IRS Rates for 2010

Taxable Income (euros)	Rates (percentage)	
	Standard (A)	Average (B)
Up to 4 793	11,08	11,080
From over 4 793 até 7 250	13,58	11,927
From over 7 250 até 17 979	24,08	19,179
From over 17 979 até 41 349	34,88	28,053
From over 41 349 até 59 926	37,38	30,944
From over 59 926 até 64 623	40,88	31,667
From over 64 623 até 150 000	42,88	38,049
Above 150 000	45,88	

Income earned in Portuguese territory that is subject to definitive retention at source will now be subject to a withholding rate of 21.5%. This amounts to an increase of 1.5 percentage points in relation to the rate of 20% that was previously applied.

The new law provides for a withholding rate of 16.5% (an increase of 1.5%) in the following cases: (i) category E (income from capital) and F (income from real property), (ii) category B (professional and business income), earned from

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Chambers Europe Excellence 2009, IFLR Awards 2006 & Who’s Who legal Awards 2006, 2008, 2009, 2010

“Corporate Law Firm of the Year - Southern Europe”
ACQ Finance Magazine, 2009

“Best Portuguese Law Firm for Client Service”
Clients Choice Award - International Law Office, 2008, 2010

“Best Portuguese Tax Firm of the Year”
International Tax Review - Tax Awards 2006, 2008

Mind Leaders Awards ™
Human Resources Suppliers 2007

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As the new law increases the general IRS rates, by 0.58% and 0.88% depending on the income bracket, and bearing in mind that these increases come into effect in the middle of the financial year 2010, on 1 July 2010, the question again arises as to whether the increases apply to income earned between 1 January 2010 and the date the law came into force.

intellectual or industrial property or from the provision of information relating to experience gained in the industrial, commercial or scientific sector when earned by the original holder, to (iii) compensation for non-monetary losses, except for those awarded by a court of law or arbitration tribunal or arising from a legal agreement, for unproven actual damages and loss of profits. The latter only encompasses compensation for the failure to receive liquid benefits as a consequence of the injury and (iv) amounts earned from the assumption of non-compete undertakings regardless of the respective source or basis.

In turn, category B income earned in the financial year by the self-employed from the provision of services including those of a scientific, artistic or technical character, whatever their nature, even connected with commercial, industrial, agricultural, forestry or livestock activities, as well as the subsidies, grants or the income arising from single acts done in the exercise of these activities are subject to a new withholding rate of 11.5% (this also represents an increase of 1.5%).

Furthermore, category B income earned in the context of services provided under the remaining Portuguese Economic Activities classified by Branches of Activity (CAE) of the National Institute of Statistics, or in accordance with the codes mentioned in the table of activities approved by the order of the Minister of Finance, is subject to a new withholding rate of 21.5%.

Finally, those earning category B income subject to payments on account see the total for these payments increase from 75% to 76.5% (another increase of 1.5%).

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In this context, since the 1997 constitutional revision, the Constitution of the Portuguese Republic has provided that no one may be required to pay taxes of a retroactive nature. In the same way, the *Lei Geral Tributária* (General Tax Law) provides that, as the new law applies to taxable events that are established progressively – as is the case with IRS -, the new law may only apply to the period beginning with its entry into force and although this provision of the General Tax Law does not prevent later law from repealing it or making provisions that contradict it, the ideal solution in these cases seems to be to divide the annual period into two parts applying the new more onerous IRS rates table only to income that is paid or made available after the date the new law came into force.

This means there will be those who claim that the application of the new general IRS rates table to income earned between 1 January of this year amounts to retroactivity (said to be of the third degree), and that such application would be unconstitutional when and if applicable to such income earned before the law came into force.

However, another approach is that this (said to be) complex taxable event, which is established progressively, only truly and concretely takes effect at the end of the year on 31 December, despite the fact that it begins on 1 January. This is not strictly retroactivity but, instead, it is no more than “retrospectivity” involving expectations that the Constitution does not protect in the context of prohibition of retroactivity because there is no right of immutability in relation to tax law, but rather in the context of legal certainty. This will always be more difficult to argue in the context of IRS, given that for IRS there is no express provision that the sets the establishment of the taxable event at the end of the tax period, unlike in the case of IRC (corporate income tax).

Accordingly it is not settled whether the application of the new table to income earned before the law came into force will resist the request made by the President of the Republic for the Constitutional Court to assess the new law and to consider its constitutionality.

2. Corporate income tax (IRC)

For corporate income tax - IRC as it is known in Portugal - the new law provides for an additional rate of 2.5%, called the *derrama estadual* or state surtax, on taxable profits in excess of €2 000 000.00 subject to and not exempt from tax that are earned by companies resident in Portuguese territory with their main activity being of a commercial, industrial or agricultural nature, as well as companies considered not to be resident in Portugal but which have a permanent establishment here.

In the case of the special tax framework for groups of companies, the new law regulates the way in which the additional rate of 2.5% should be applied. This additional rate is paid on taxable income established in the individual periodic declaration of each of the companies in the group including the controlling company.

Companies which earned taxable profits exceeding €2 000 000.00 in the tax year 2009 and which are currently required to make payments on account and special payments on account must now make additional payments on account of tax. This means that on the date for the three payments on account that they were already required to make - which, in general terms, fall due in July and September and on 15 December of the same year of the taxable income in question or, in the case of companies with a financial year that does not correspond with the calendar year, in the seventh and ninth month and on the 15th of the last month of the tax period in question - they must make an additional payment on account equal to 2% of the part of the taxable income that exceeds € 2 000 00.00 relating to the previous tax period. The same applies to additional payments on account for each of the companies in the group covered by the special tax framework for groups of companies.

The payment must be made up to up to the last day of the period fixed for sending the annual income declaration or for sending the substitution declaration. The amount to be paid must be calculated on the difference that exists between the state surtax calculated for the case and the amounts paid on account of the additional payment on account referred to above.

However, the new law creates an exception for cases in which the value of the state surtax to be paid by the taxpayer is lower than the amounts paid as the additional payment on account. In these situations, the taxpayer will receive a rebate.

The IRC Code provides that the taxable event is established on the last day of the tax period. This makes it more difficult to maintain that the application of the state surtax to taxable income in excess of € 2 000 000.00 established with reference to the tax year 2010, violates the principle that tax laws should not have retroactive effect.

3. Value Added Tax (IVA)

The new law also establishes an increase in value added tax, known in Portugal as IVA. With the coming into force of the new law on 1 July 2010 the reduced rate changes from 5% to 6%, the intermediate rate from 12% to 13% and the standard rate from 20% to 21%. The IVA rates applicable in the Azores and Madeira also go up with the intermediate rate increasing from 8% to 9% and the standard rate from 14% to 15%. However, the reduced rate remains the same at 4%.

In cases where the invoicing or its registration are processed by values which include tax, the establishment of the corresponding taxable amount will, naturally, be reached by dividing those values by 106 when the tax rate is 6%, by 113 when the tax rate is 13% and by 121 when the tax rate is 21%, and then multiplying the quotient by 100 and rounding the result upwards or downwards to the nearest unit.

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4. Stamp Duty (IS)

The new law also establishes an increase in tax in the form of stamp duty (in Portuguese *Imposto Selo* or *IS*) on the granting of loans in the context of consumer credit contracts. In accordance with what the new law establishes, the extension of the term of a pre-existing credit contract is equivalent to the granting of a new contract so it is also subject to the new rules for the application of IS.

Accordingly, consumer credit has become more expensive for the consumer with the following rates for IS: (i) credit for a period of less than one year, for each month or fraction of a month, is now subject to IS at the rate of 0.07% (compared to the previous rate of 0.04%); (ii) credit for a period equal to or greater than one year will be subject to an IS rate of 0.90% (compared to the previous rate of 0.50%); (iii) credit for a period equal to or greater than five years will be subject to an IS rate of 1% (compared to the previous rate of 0.60%); and (iv) credit used as a current account, bank overdraft or any other form in which the period of use is not or cannot be determined, on the monthly average obtained from the sum of the balances owed calculated on a daily basis throughout the month, divided by 30, will be subject to the IS rate of 0.07% (compared to the previous rate of 0.04%).

However, these changes will only take effect in relation to consumer credit granted after the date the law comes into force, that is, 1 July 2010.

5. Excise Duties (IEC)

The new law also makes changes to excise duties known in Portugal as *Impostos Especiais sobre Consumo* or *IEC*. The changes relate to the tax on cigarettes consumed in the Autonomous Region of Madeira and made by small producers whose annual production does not exceed 500 tonnes. In these cases the following rates will be applied: (i) on the specific element (tax on 1000 cigarettes) the rate increases from the previous € 9.28 to € 15.00; (ii) the current rate of 36.50% remains in place as the rate for the ad valorem element.

As excise duties (IEC) fall upon taxable events that arise instantaneously, in other words, on the cost inherent to consumption, the new rates only apply to tobacco purchased after the date the new law comes into effect.

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