



## TAX LAW PRACTICE AREA

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## EDITORIAL

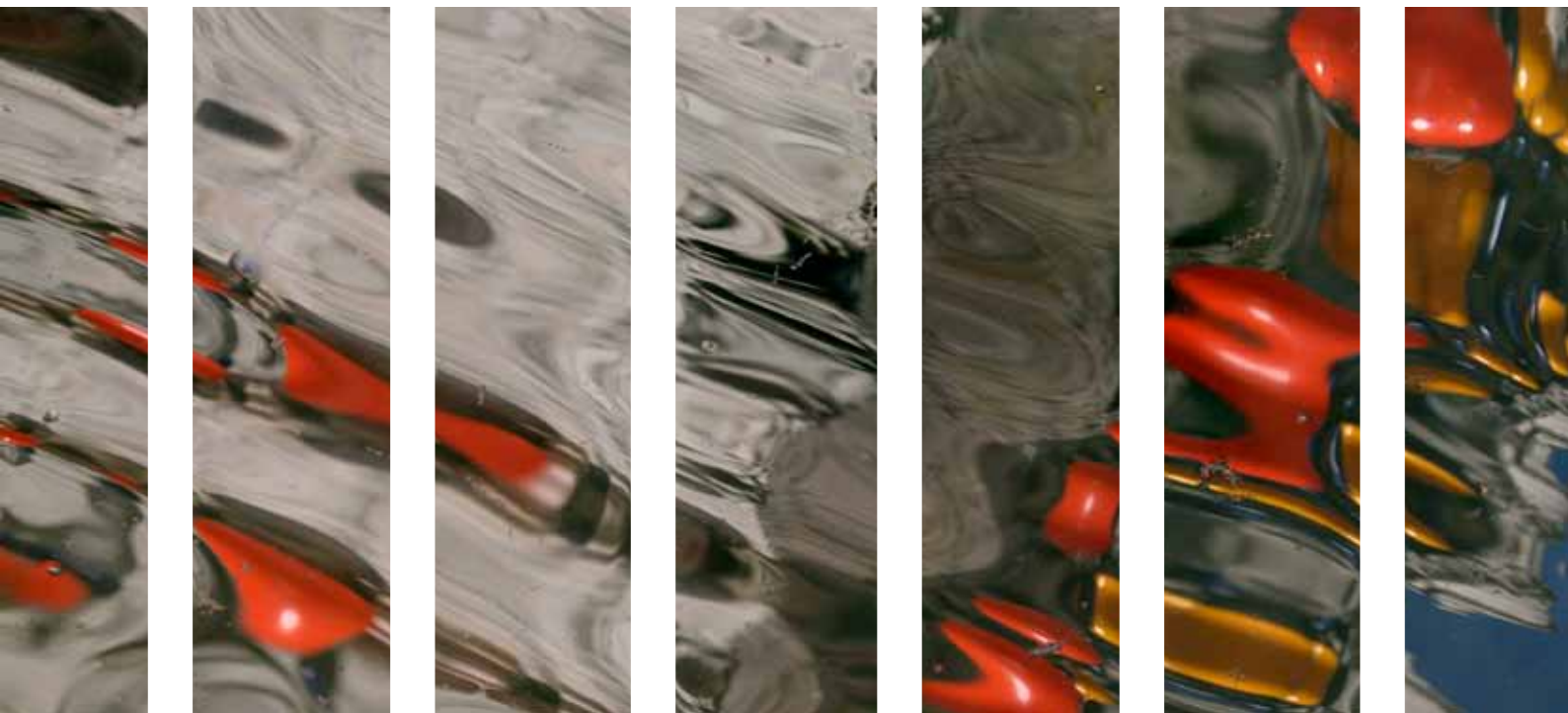
It is with great pleasure that we present our 2010 second quarter Newsletter, prepared by the Tax Law Practice Area ("APDF").

In this Aware, we analyse two hot topics. The first article is on the RERT II (Exceptional Regime for Regularization of Taxes), which is in force until December 16, 2010. The second article is on "Arbitration and Tax Litigation". We hope that arbitration will soon constitute an alternative mean of resolving conflicts in the tax area, putting an end to the long-pending cases before the Tax Courts.

As usual, we also include our summaries of the most relevant tax legislation and generic guidelines from the Tax Authorities for the second quarter of 2010, respectively in sections "Law says..." and "Tax Authorities determines...".

We hope you enjoy this Newsletter and we would very much appreciate receiving your comments or suggestions. 

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## COME BACK, YOU ARE FORGIVEN: THE TAX AMNESTY V. 2010

This is not an original measure. Already in 2005, under Law No. 39-A/2005, of 29 July, first amendment to Law No. 55-B/2004, of 30 December (which approved the Public Budget for 2005), was approved the Exceptional Regularization Tax Regime (RERT) of patrimony located outside Portuguese territory on 31 December 2004.

In fact, the results of the RERT in terms of tax revenue collection are not known. Official<sup>1</sup> sources only made a laconic reference to the fact that "... *the growth of tax revenue for the 2005 tax year is negatively influenced by the financial effect of the amendment to the Corporate Income Tax (IRC) tax rate in 2004, and positively influenced by the increase of revenue resulting from the increase of the VAT standard rate as well as by RERT (exceptional regularization tax regime of patrimony held abroad)*," and nothing is referred to in concrete terms.

According to other sources<sup>2</sup>, the RERT was significantly "below the expectations, since the revenue collected was about of 20% of that proposed by the Government".

In spite of this, a new tax amnesty was issued, aiming at attracting additional tax revenue for the State, encouraging the return to Portugal and the "legalization" of capitals with obvious benefits for the State as well as for the national financial system which both need the resources. One thing is certain, the new law does not foresee the capital standby duty in Portugal, which would be illegal, as against the principle of free movement within the European Union, and for such we will see if the purpose of this tax amnesty is achieved.

The 2010 version of the Exceptional Regularization Tax Regime of patrimony (hereinafter RERT II) is included in Law No. 3-B/2010, of 28 April, which approved the Public Budget for 2010.

In order to regulate the RERT II, Ordinance No. 260/2010, of 10 May, adopted the model declaration to be used for tax regularization.

Similarly to the previously mentioned one, the description of this new regime is quite informative regarding its purpose. This regime allows the tax regularization, on patrimony, such as deposits, certificates of deposit, securities and other financial instruments, including life insurance policies regarding investment funds and transactions of capitalization from life insurance instruments.

The RERT II applies to all who have patrimony outside Portuguese territory on 31 December 2009, allowing them to regularize their tax situation before the Portuguese Tax Authority (DGCI) until December 16, 2010.



**In order to regularize their situation, they must:**

**1<sup>st</sup>** Submit the declaration (available in the Annex to the referred Ordinance and available for printing on the website of the DGCI, [www.portaldasfinancas.gov.pt](http://www.portaldasfinancas.gov.pt)) in triplicate, to the Bank of Portugal or any credit institution;

*(continues on page 3)*

**1.** Report on fighting tax fraud and evasion, Ministry of Finance and Public Administration, dated January 2006, available on the internet at the following Link: >>>

**2.** Available on the internet at Link: >>>

## COME BACK, YOU ARE FORGIVEN: THE TAX AMNESTY V. 2010 (CONTINUATION)

**2<sup>nd</sup>** Pay a tax equal to 5% of the value of patrimony declared in the submitted declaration within 10 working days after the submission;

**3<sup>rd</sup>** Transfer the declared patrimony to a bank account held in credit institution domiciled in Portugal or a non-resident credit institution's branch in Portugal, in case the patrimony is outside the EU or EEA.

In order to create conditions for success to attract potential candidates, it is worth mention that with the adoption of RERT II, the following effects are verified, with regards to the declared patrimony:

- a.** Extinction of tax obligations, relating to tax periods ending on or before 31 December 2009;
- b.** Protection from liability for tax infractions related to the detention of such patrimony;
- c.** Sufficient evidence in order to avoid an indirect evaluation of the taxable amount, in case the wealth criterion but also other undeclared assets increase.

Moreover, the submitted declaration cannot, by any way, be used as a statement or relevant element for tax or criminal proceedings and all the information provided to banks being covered by banking secrecy.


Thus, we recognize that the legislative provisions used are much clearer in RERT II. However, this new regime still raises some doubts.

For example, in cases where the patrimony in question was outside the European Union or outside the European economic area on 31 December 2009, but on a date prior to the submission of the RERT II, were transferred to a European Union country or European economic area, can we conclude that in such cases (the patrimony was, for example in France before the submission of the RERT II declaration) the taxpayer has no obligation to transfer it to Portugal?

In such situations, is the fulfilment of the declaration to the Bank of Portugal or any other institution and the payment of the fee of 5% enough?

We will answer both questions in the affirmative, otherwise we will be facing a new violation to the free movement of capitals. This however obviously defrauds the State's expectation to inject capital into the financial system.



Finally, some practical information for any interested parties. DGCI has created an information service for clarification of tax-related questions derived from the application of RERT II, indeed, there are two e-mails to which one may send clarification requests via e-mail to the DGCI: **[dsirc@dgci.min-financas.pt](mailto:dsirc@dgci.min-financas.pt)** for legal entities, and **[dsirs@dgci.min-financas.pt](mailto:dsirs@dgci.min-financas.pt)** for individuals. Clarifications on issues of operational nature must be obtained at the Bank of Portugal, by e-mail, to the following address: **[rert@bportugal.pt](mailto:rert@bportugal.pt)**. 

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## ARBITRATION AND TAX LITIGATION

**1.** To begin this article, one must first refer to the legal authorisation granted to the Government in the State's Budget Law of 2010 (Law No. 3-B/2010, of April 28) (hereinafter, "OE" or "legal authorisation law") allowing the Government to legislate on tax arbitration matters as an alternative method to settle tax conflicts.

The alternative methods of settlement to litigation mentioned in OE is designed to reinforce the effective and efficient supervision of legally protected interests of taxpayers, and had already been subject to analysis in the Report of the Study Group of Tax Policy – Competitiveness, Efficiency and Justice of the Tax System (hereinafter, "Tax Policy Report" or "Report")<sup>1</sup>. The conclusions contained in the Report suggested the adoption of alternative ways of settle tax conflicts, and arbitration and conciliation in particular seem to have obtained the legislator's acceptance.

**2.** In a very simplistic way, the legislator's intention seems to be making a way to settle tax litigation available for taxpayers, under which the parties submit their claims to the appreciation of a jury of experts. As this is an alternative way to settle disputes, the jury – which under the terms of the legal authorisation law must be impartial and independent – will neither be the Tax Administration (hereinafter, "TA") nor Judges of Law. It will be composed of three members, two of which be will chosen by each party, and a third, the president, who will be chosen by the appointed two.

It is understood that the decision of the Arbitration Court will be binding to the parties, in the same terms as a decision from a Tax Court,

thus making it impossible – unlike what happens in the decisions of tax procedures in first instance – to appeal (without prejudice of the possibility to appeal to the Constitutional Court).

**3.** It is difficult, at this moment, to anticipate the exact wording of the "future" law on tax arbitration, however, one can point out the following elements already included in the legal authorisation law (that should be present in the drafting of the final law), and that deserve our best attention:

**a)** The scope of arbitration was decided to be only for matters that are the object of a legal claim (*impugnação judicial*) or a claim for the recognition of a right or legitimate tax interest. Under these terms, there are some areas of tax disputes that are not arbitrable, such as the challenge of the tax enforcement procedure. In our opinion, the legislator could have gone slightly further, including other situations within the scope of tax arbitration. We point out, as an example, the challenge of the enforcement procedure (particularly in situations when the procedure reverts to the managers and directors of a company), as it is a very delicate situation which demands urgent attention.

**b)** We also point out the fact that the legislator took a stand on the decision powers of the arbitrators, prohibiting the use of equity. Notwithstanding what is suggested in the Report<sup>2</sup>, the rulings of the arbitration court can only be based on positive law.

(continues on page 5)

**1.** See Report of the Study Group of Tax Policy – Competitiveness, Efficiency and Justice of the Tax System, under the general coordination of António Carlos dos Santos and António M. Ferreira Martins and coordination of the subgroups João Amaral Tomaz, Rui Morais, Sidónio Pardal, António Nunes dos Reis and Rogério M. Fernandes Ferreira, pp. 654 and following.

**2.** The Report seems to suggest a medium solution of «mixed arbitrators» that, concerning the matter of determining the application of the law and the applicable tax rates, would be restricted to the strict application of the law, but not so much on determining the exact value of the assets, of the taxable amount or of the amount to pay or to receive – namely through the evaluation of assets and rights, acceptance of certain expense as cost, probable presumption of income in simplified regimes or in situations of difficult proof, etc – might decide according to opportunity criteria. Vide relatório, pag. 716, ponto 320.

## ARBITRATION AND TAX LITIGATION (CONTINUATION)

**c)** The legal authorisation law also seems to dismiss the proceeding of essential formalities, which in our opinion doesn't seem to match the informal and fast nature of the procedure.

**d)** Providing for a time period of six months, renewable once, before an award is rendered seems to be one of the greatest advantages of tax arbitration, as the delay in obtaining a decision is one of the flaws often attributed to arbitration.

What seems peculiar however, is the fact that the Government is authorised to legislate in order to make arbitration into an alternative means to settle tax conflicts, but Article 124 (4) subparagraph o) of OE refers to arbitrators, mediators or conciliators; Is this an open door to other means of settling tax claims, such as mediation...? The question remains unanswered.

**4.** In addition to attempting to predict and speculate on the upcoming changes, we find relevant to outline the grounds of an analysis of the matter under examination: arbitration and tax litigation.

The difficulties that tax litigation currently faces and way it is developing make us look around to other branches of the law, and other ways of settle disputes, with the expectation of finding solutions to the current problems.

The delay in the procedures, which tend to remain at a stop for years – with costs to all parties involved – , the frequent lack of specific and technical knowledge, or even sensitivity to tax matters, creates a general distrust in the judicial tax system by the taxpayers, but also by the Courts and the Tax Administration, that also point out flaws to litigation (we underline the lack of means of action).

By the end of 2009, there were about 43805 tax procedures pending before the tax Courts, amounting to over 13 thousand million euros (and this amount will keep increasing if we believe last years trend). Also, according to the recently disclosed figures, administrative claims are ruled in favour of the taxpayer 61% of the cases, to which we can add 5% of decisions that are partially decided in favour of the taxpayer (in 2009, these procedures represented about 222 million euros).



Curiously, administrative claims decided in favour of the Tax Administration amount to about 486 million euros.

Besides the delay in obtaining tax justice, we also point out the merely formal analysis of tax issues (sometimes overlooking the real issues out of mere easiness) as well as the costs of the procedure itself, particularly the costs of ordering a guarantee, sometimes based on a superficial analysis.

All these elements, known to the taxpayers who apply tax law as well as to all those who deal with tax litigation, create doubts and distrust in the current regime, and cause to reflect on new alternatives.

But will the solution be arbitration and other means of settlement?

*(continues on page 6)*

## ARBITRATION AND TAX LITIGATION (CONTINUATION)

5. Generally, there are several advantages to the use of arbitration (even recognised in the Tax Policy Report): the quickness in obtaining a decision, the efficiency of arbitral tribunals and the general simplification of the proceedings are some of the most favourable arguments.

There are even those who believe, from a different perspective, that these solutions (alternative settlement of litigation) may contribute to a closer relationship between the Tax Authorities and the taxpayers, as it will create a space for dialogue and compromise pending a decision.

On the other hand, there are some who criticise the prejudice to the public welfare deriving from the impossibility of the arbitrators to be effectively impartial. We also point out the risk that the costs inherent to arbitration will leave out small taxpayers, generating one more element of distrust and social injustice.


Among the issues to analyse, and as some point out, there is a possibility that the principle of taxation based on the taxpaying capacity is replaced by the principle of taxation based on the negotiating<sup>3</sup> capacity.

6. In our opinion, in light of the current situation of tax litigation, opening the door to arbitration and other means of settlement of tax disputes seems to be the right step. In fact, considering the limits of the current tax litigation mentioned above, and the favourable arguments that were presented, we believe that arbitration may be a believable and likely alternative (although its current frame, still pending on the Government's will, may not be our favourite).

Adopting the old Roman principle that *to Caesar's wife it's not enough to be honest, one also needs to look honest*, without hindering the need to solve the downsides of the current tax litigation, it is nevertheless important to give the taxpayer an idea of transparency and justice in the tax decision.



Thus, we believe that the dialectic arising from arbitration and the greater proximity between the taxpayer involved in tax litigation and the proceeding itself, may positively affect the image of the "system". We must not forget that the imposing character of a tax, conditioning the free management of private property, makes the topic of tax justice that more sensitive. The sense of patrimonial limitation makes it easier to perceive the quickness and fairness of the tax system, and ultimately a greater belief in tax litigation.

However, we question if the privatisation of justice, and particularly tax justice, is the solution to the problem, or merely proof that the current system is faulty and needs to be improved. This issue concerns the question of whether tax arbitration is just a patchwork, instead of solutions that should be implemented, such as forming more and better judges, i.e., to create the necessary means to decide on pending claims and to relieve the overloaded Courts, implementing similar measures in the Tax Authorities. 

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<sup>3</sup>. See Diogo Ortigão Ramos and Pedro Vidal Matos

## LAW SAYS ...

**Law No. 3/2010, of April 27**, that foresees that the State will have to pay interest for the delays for complying with any of its monetary obligations.

**Law No. 3-B/2010, of April 28**, that published the State's Budget for 2010.

**Normative Order No. 260/2010, of May 10**, that approves the form in which to declare patrimony which is abroad and the respective instructions to do so.

**Implementing Order No. 8603-A/2010, of May 20 – II Series, No. 98**, that approves the withholding tax rates to apply in 2010, for IRS purposes.

**Implementing Order No. 8843-A/2010, of May 24**, that clarifies the doubts emerging from the content of Implementing Order 8603-A/2010.

**Normative Order No. 293/2010, of May 31**, that revokes No. 9 of Normative Order 523/2003, of July 4, which approves to form in which to declare the payment of source withholdings on IRS and stamp tax duty.

**Normative Order No. 303/2010, of June 08**, that regulates the deductions to make to the taxable amount for IRS purposes, regarding environmental effectiveness equipments, and revokes Normative Order 725/91, of July 29.

**Implementing Order No. 1/2010/M, of June 14**, that approves the withholding tax rates to apply in 2010 to the Autonomous Region of Madeira.

**Law No. 11/2010, of June 15**, that introduces a new IRS tax (of 45%) applicable to taxable persons or families whose annual income is of more than (euro) 150.000,00.


**Decree-Law No. 72-A/2010, of June 18**, that foresees the rules to execute the State's Budget for 2010.

**Implementing Order No. 10444-A/2010, of June 22**, that approves the withholding tax rates to apply in 2010 to the Autonomous Region of Azores.

**Normative Order No. 363/2010, of June 23**, that regulates the prior certification of software invoicing programs, according to the Portuguese Corporate Income Tax Code.

**Normative Order No. 454-A/2010, of June 29**, that approves form No. 39, «Income and withholding tax rates for final withholding taxes and the respective instructions to do so.

**Law No. 12-A/2010, of June 30**, that approves some additional budgetary consolidation measures aimed to reinforce and accelerate the reduction of the excessive deficit and control the growth of public debt, as foreseen in the Portuguese Stability and Growth Program (PEC).

**Implementing Order No. 18-A/2010, of July 1**, that regulates the terms of the applications to request the VAT refund and the terms and conditions of access to the refund monthly regime foreseen in Article 22 (8) and (9) of the Portuguese VAT Code. It also revokes Implementing Order No. 53/2005, of December 15. 

## TAX AUTHORITIES DETERMINE THAT ...

**Binding Ruling No. 217/10**, regarding construction works made on own account and sold in fractions.

**Administrative Ruling No. 20145/2010**, of April 05, issued by the Corporate Income Tax Services Directorate, regarding the local surcharge (Derrama) levied by the municipalities to be collect in 2010.

**Administrative Ruling No. 60073/2010, of April 22**, from the Tax Justice Services Directorate, regarding the tax secrecy, article 64 of the General Tax Law; access by the law enforcement agent to the Tax Administration files.

**Binding Ruling, procedure No. 3417/2009**, regarding the tax frame of gains derived from the assets of one company, following an alteration of the company's head office to another State of the European Union.

**Binding Ruling, procedure No. 2707/2006**, regarding the tax frame of the rendering of services for air transportation.

**Administrative Ruling No. 90014/2010, of May 06**, from the Tax Collection Services, that updated and re-published the Beginning of Activity Book of Operations.

**Ruling No. 2/2010, of May 06**, from the Personal Income Tax Services Directorate, regarding the tax regime of non-habitual residents.

**Binding Ruling, procedure No. 2210/2010**, regarding property gains, amounts related to the assignment of use of common parts of a building fractioned in condominiums.

**Binding Ruling, procedure No. 377/09**, regarding the obligation of return of form No. 1 of Real Estate Municipal Tax in cases of consolidation of property with use.

**Administrative Ruling No. 40098/2010, of May 19**, from the Municipal Property Transfer Tax Services Directorate, regarding the rates to use in 2010.

**Administrative Ruling No. 90015/2010, of June 8** from the Tax Collection Services, regarding the production of the option non-habitual resident in the taxpayers' records management system (SGRC) – Decree-Law No. 249/2009, of September 23.

**Administrative Ruling No. 5/2010, of June 14**, from the Personal Income Tax Services Directorate, regarding the tax enclose of the social benefits that substitute the salary paid within the parenting protection program.

**Administrative Ruling No. 3/2010, of June 15**, from the Personal Income Tax Services Directorate, regarding the tax withholding over employment and pensions income.


**Administrative Ruling No. 4/2010, of June 15**, from the Personal Income Tax Services Directorate, regarding the tax withholding over employment and pensions income – Autonomous Region of Madeira.

**Administrative Ruling No. 20146/2010, of June 16**, from the Personal Income Tax Services Directorate, regarding the control of default situations – default on annex G/G1 of year 2006 - Article 76 (1) subparagraph b) and (3), of the Personal Income Tax Code – revision due to Services' fault.

**Administrative Ruling No. 90016/2010, of June 23**, from the Tax Collection Services, regarding the granting of a taxpayer number to inheritances / activity declarations.

**Administrative Ruling No. 30117/2010, of June 25**, from the VAT Services Directorate, regarding VAT on heat bombs.

**Administrative Ruling No. 6/2010, of June 25**, from the Personal Income Tax Services Directorate, the tax withholding over employment and pensions income – Autonomous Region of Azores.

**Administrative Ruling No. 30118/2010, of June 30**, from the VAT Services Directorate, regarding the amendment of VAT minimum, medium and normal tax rates. 

This *Aware* is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects that are referred. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions. For more information please contact us at [apdf@abreuadvogados.com](mailto:apdf@abreuadvogados.com) | Visit our website [www.abreuadvogados.com](http://www.abreuadvogados.com)

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