9. The Portuguese tax system

Summary

This chapter presents the main characteristics of the Portuguese tax system. It begins with a description of tax reforms in Portugal from the '80s, presents the main taxes and tax benefits from current tax system. It compares Portugal with the EU average on indicators of structure and burden of taxation, ending with a critical assessment of the overall tax system.

The Portuguese tax system at present consists essentially of *income taxes* (particularly the tax on personal income - income tax IRS - and the corporation tax (IRC); *contributions to Social Security* (CSS) , taxes on *wealth* (e.g. real property tax (IMI)), *general tax on consumption* (value added tax VAT), *excise taxes* (tax on petrol products (ISP), vehicle tax (ISV), tax on tobacco consumption (IT), tax on alcohol and alcoholic beverages (IABA)), other indirect taxes (stamp duty, gambling, etc.). and taxes on international transactions (import duties customs and surcharges).
The current system is relatively recent. The VAT was created in 1984, the IRS and IRC, which incorporated a set of partial revenues, came into force in 1989. The IMI replaced the council tax, and the IMT, a property transfer tax, replaced an old tax called *siza.* Jointly, just for taxes - VAT, IRS, IRC and CSS - represent more than three quarters of total tax revenue.
The *IRS* is a customized tax, taking into account the characteristics of the household, and is unitary encompassing a wide variety of categories of income: income as an employee, income from liberal professions and business, income from capital, real estate, capital gains, gambling and even pensions. It is a progressive tax, and is subject to taxation the income earned by individuals resident in Portuguese territory and also the income from non-residents generated in Portugal.
The unitary and customized *IRS* makes it one of the few instruments of public policy to implement the concepts of vertical and horizontal equity. The process of determining the tax yields follows in general the following steps for a household with income from employment: i) determining the gross income of household members, ii) specific deductions, including contributions to social security (to avoid double taxation) to determine net income, iii) calculating the tax yields through the application of marital quotient (dividing by two in the case of a couple) and apply increasing marginal tax rates to income divided in different tax brackets . Finally, from the computed tax yields it is possible to subtract some expenses (deductions according to the number and type of household members, expenditures on education, health, etc..). A progressive tax is ensured by increasing marginal tax rates that apply to income earned in each bracket. Thus we obtain an average tax rate which is a monotonic increasing function of income.
The *IRC* is a single tax levied on corporate's profits (limited liability companies or public companies, cooperatives, public or private companies) with registered office or effective management in the Portuguese territory as well as on income from non-resident legal corporations but with taxable income generated in the Portuguese territory. The determination of taxable income varies with the nature and size of entrepreneurial activity. When taxable income is based on profit, it is possible to deduct expenses proved necessary for the activity, some of which are well regulated (case of maximum rates of depreciation by type of equipment, supplies, entertainment expenses, gifts, etc.). Upon creation of tax (1989), the income tax rate was 36.5%, while in 2011 it is 12,5% for profits below €12.500 and 25% for the remaining part, in entities primarily engaged in the industrial, commercial or agricultural activities. There are lower rates to other entities (20% to entities not engaged in activities primarily commercial, industrial or agricultural) or to companies whose effective activity is carried

out in areas of the countryside (15% and 20%).[1] There are exemptions, for example to nonprofits.
VAT is a general tax on transfers of goods, services, imports and acquisitions of goods and services and is applicable broadly to all phases of the economic circuit occurred in the Portuguese territory. Are liable to pay the tax individuals or legal entities engaged in production, trade or service or buyers of certain goods and services. There are three rates of VAT, in 2013 a reduced rate of 6% applied to food items, water, transport, entertainment, most drugs with a prescription, etc.., An intermediate rate of 13% applied to flowers and ornamental plants and restauration among others and a standard rate of 23% applied to all other goods and services.
Contributions to Social Security (CSS) are contributions to social security by employers and employees. The rates are 11% on wages earned by wage earners and the rate of 23.75% by their employers. These contributions finance the social benefits (sickness, maternity, unemployment, retirement, etc.).
The *tax benefits* of the Portuguese tax system are also an important instrument of public policy. The benefits translate into tax exemptions, fee reductions, deductions to income or to the tax yields (the amount of tax that should be collected without benefits). They are justified mainly on grounds *of fairness* (handicapped persons in IRS, location of firms in the interior in IRC) or *efficiency* (copyright in the IRS, investment in R & D on IRC).
Tax revenues are divided by territorial levels of administration. The IRS, corporate tax and VAT are essentially state revenues if the income is generated within the continent and they are revenues of the autonomous regions of Azores and Madeira if they originated in these regions.

Municipalities may levy a tax on taxable income of corporations whose revenues are generated in the municipality (up to 1.5% of taxable income). Also under the Local Finance Law (Law 2 / 2007), they are now entitled to a maximum of 5% of IRS collected in the municipality. If opting for a lower rate than the maximum, the difference is a tax credit of residents (eg the choice of the 2% rate by the city council represents a tax deduction of 3% for their respective citizens). Part of the revenue of the single "vehicle circulation tax" (IUC created by Act 22 of 2007-A June 29) goes to the municipalities and partly to the State and the Autonomous Regions.
An analysis of the level of taxation in Portugal (the ratio between tax revenues and social security on GDP mp) shows a significant evolution from 1980 to 2003 (from 24.1% to 37.1%) compared to the average EU-15 (increased by 4, 5 percentage points). However, in 2012 the Portuguese ratio was 34,9 which compares with 40,6 of EU27. Portugal being significantly below the EU average. Regarding the tax structure (percentage of each type of tax in tax revenue) the burden of indirect taxes (VAT and excise duties on consumption) is significantly above the EU average and OECD countries.

[1] This positive discrimination of the interior regions of Portugal, is no longer in place in 2013.