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ABSTRACT

This article provides an overall tax analysis of the complexity of the Portuguese tax system. Before discussing whether we should change the way we tax ourselves, it will be useful to compare the Portuguese tax system to other OCDE and European countries. However, the main aim of this study is to discuss the main aspects that make the Portuguese tax system complex and difficult to enforce. Then, in order to simplify the Portuguese tax system, we will focus on economic, administrative and legislative issues that have introduced some kind of complexity in the tax system.

Key words: Portuguese tax system. Complexity. Costs of taxation.

RESUMO

Este artigo fornece uma análise tributária geral da complexidade do sistema tributário português. Antes de discutirmos se devíamos mudar a forma como nós tributamos, será útil comparar o sistema tributário português ao de outros países europeus e da OCDE. Porém, o primordial objetivo deste estudo é discutir os principais aspectos que fazem com que o sistema tributário português seja complexo e difícil de aplicar. Então, para simplificar o sistema tributário português, nos concentrar-nos-emos nas questões econômicas, administrativas e legislativas que introduziram algum tipo de complexidade no sistema tributário.

Palavras-chave: Sistema tributário português. Complexidade. Custos da tributação.

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1 INTRODUCTION

There are three classic criteria for judging a tax system: fairness, neutrality, easiness of enforcement and simplicity. Nowadays, in Portugal, tax reformers emphasize simplicity more than ever. This attitude is the result of an increasing awareness of more and more complex Portuguese tax legislation, as well as the erosion of taxable amounts and the consequent increase of tax avoidance and evasion.

This article provides, therefore, an overall tax analysis of the Portuguese tax system's complexity. Before discussing whether we should change the way we tax ourselves, it will be useful to consider the basic features of the Portuguese tax system.

Thus, the study will be divided into three parts. Firstly, we will start surveying how much revenue governments at all levels take in, what kinds of taxes they use, and how our tax system compares to other OCDE and European countries.

Secondly, we will point out the basic frameworks of the Portuguese income tax, personal and corporate income taxes, the two main targets for reform or replacement in the present political debate. Thus, here, we will explain the essentials of how these taxes work and clarify some of the terminology that appears whenever tax reform is discussed.

Thirdly, we will explain and discuss the main aspects that make the system complex and difficult to enforce. We will begin by examining just the economics issues that have introduced complexity recently and then we will look at administrative and legislative complexity in the Portuguese tax system.

Finally, we will try to summarize as conclusions the results of our analysis.

2 INTERNATIONAL COMPARISONS

To do international comparisons we will use the ratio TAX/GDP, which is usually represented by the total tax revenues relative to the size of the economy. Tax revenues include all the taxes usually collected from taxpayers such as income tax, personal and corporate, consumption taxes, property taxes, and in some countries also national social contributions. In turn, GDP is a measure of the total money value of all goods and services produced within the different countries in a single year (see SLEMROD, Joel; BAKIJA, Jon . Taxing ourselves: a citizen's guide to the great debate over tax reform. 2. ed. Massachusetts Institute of Technology, p. 17-47, 1998).

Therefore, as we can see in the chart below, over the past decade, Portugal's tax system has developed similarly to other OECD countries.

Table 1 - Tax/GDP Ratios in OECD Countries

	1985	1990	1995	2000	2002	2003
Portugal	26,6	29,2	33,6	36,4	36,5	37,1
OECD Total	33,5	34,8	35,7	37,1	36,4	36,3
OECD Europe	36,4	37,3	38,3	39,7	39,0	38,9
EU 19*	38,6	39,3	39,9	40,4	39,6	39,4
EU 15*	38,6	39,3	40,1	41,7	40,6	40,5

Source: OECD (2005); *Revenue Statistics 1965-2004*, Paris, p. 19.

* EU 15 area countries are: Áustria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

* EU 19 area countries are: EU 15 countries plus Czech Republic, Hungary, Poland and Slovak Republic.

The overall tax burden (total tax revenue/GDP) in Portugal, as the Table 1 shows, has been increased considerably over the past 20 years. Between 1985 and 2003, the Portuguese tax burden rose by 10 points mainly due to the steady expansion of public spending,

particularly commitments to the development of welfare provision (This growth occurred mainly in corporate income tax revenues, as a result of the reduction of some tax incentives and deductible costs, and in consumption taxes as we will see forward).

The tax – to - GDP ratio was approximately, in 2003, at 37,1 percent of GDP. As we can see in the table above, such ratio is not high by international comparison with other countries in the European Union as well as in OECD - The overall tax burden ratio is higher when measured according to national accounts.

The difference mainly stems from imputed employer's social security contributions for government employees that are counted as taxes in national accounts but not in OCDE revenue statistics, although this does not change the position of Portugal with respect to the EU and the OCDE averages.

Table 2 examines the differences in overall levels of taxation, expressing total taxation (including social security contributions) as a percentage of GDP at market prices in 2003.

Table 2 - Total tax revenue as percentage of GDP

Countries	Total tax revenue as percentage of GDP - 2003
Sweden	50,6
Denmark	48,3
Belgium	45,4
Finland	44,8
France	43,4
Italy	43,1
Austria	43,1
Luxembourg	41,3
Netherlands	38,8
Portugal	37,1
Germany	35,5
United Kingdom	35,6
Spain	34,9
Canada	33,8
Australia	31,6
Switzerland	29,5
United States	25,6
Japan	25,3
Unweighted Average:	
OECD Total	36,3
EU 15	40,5
EU 19	39,4

Source: OECD (2005); *Revenue Statistics 1965-2004*, Paris, p. 19.

The Table 2 shows a variation in overall tax level from over 50 percent of GDP (Sweden) to under 30 percent (Switzerland, United States and Japan).

In relation to the size of its economy, Japan has lower taxes than almost any OECD of comparable countries. United States was just slightly above Japan, with taxes equal to 25,6 percent of GDP. In turn, Sweden had taxes amounting to a whopping 50,6 percent of GDP, followed by Denmark with 48,3 percent of GDP.

On average, Portugal raised taxes equal to 37, 1 percent of GDP, below the 40,5 percent of GDP for European Union 15 but slightly above OECD countries with 36,3 percent of GDP.

The Table 3 looks at the main groups of taxes expressed as a percentage of total taxation.

Table 3 – The structure of taxation by type of tax in selected OCDE countries 2003

Countries/Taxes	Taxation by type of Tax (in per cent of total tax revenue)				
	Corporate Income Tax	Individual Income Tax	Social Security and payroll taxes	Consumption Taxes	Other Taxes
Canada	10,4	34,6	17,5	26,1	10,0
Italy	6,6	25,1	29,4	25,7	8,0
Ireland	12,9	26,5	15,4	38,4	6,5
France	5,7	17,5	39,9	25,5	7,3
Germany	3,5	23,9	40,5	29,4	2,4
Greece	9,2	13,7	36,1	35,8	4,5
Japan	13,0	17,5	38,5	20,3	10,3
Portugal	8,7	15,8	31,7	36,7	4,1
Spain	9,0	18,6	35,3	28,2	7,5
United Kingdom	7,8	28,7	18,5	32,7	11,8
United States	8,1	35,3	26,4	18,2	12,1
OCDE TOTAL	9,3	24,9	27,0	30,4	5,6
OCDE EU	8,4	23,6	29,7	30,6	4,7
EU 19	8,1	22,6	31,8	30,0	4,6
EU 15	8,1	25,0	29,8	28,9	5,2

Source: OECD (2005); *Revenue Statistics 1965-2004*, Paris, p. 65-85.

The Table 3 above presents the major taxes used by different countries in OECD, illustrating the relative importance of each.

Here again, considerable divergence is apparent. The United States and Canada are the two countries with the heaviest reliance on income tax (over 40 percent) whilst Greece, France, Germany and Portugal are the four countries with the lowest percentage of tax revenue from this source.

The divergences regarding goods and services taxes are less extreme but still marked, with United States and Japan under 20 percent of tax revenue from goods and services taxes, whilst Ireland, Greece, United Kingdom and Portugal obtain over 30 percent.

A particular characteristic of the current Portuguese tax system is, actually, the relatively heavy reliance on consumption taxes, which now account for 36,7 percent of total tax revenue, much above OECD and EU averages - OCDE (2005); *Revenue Statistics 1965-2004*, Paris, p. 22-24, as can be seen in the Table 3.

Therefore, the biggest source of tax revenue in Portuguese tax system is the consumption taxes. The relatively heavy reliance on consumption taxes became greater following the introduction of the VAT system and a subsequent broadening of its base, and was also due to growth in excise taxes, especially taxes on petroleum products, motor vehicles and tobacco.

Contributions to social insurance are the second largest source of receipts, providing 34,75 percent of total revenues. Social security, which finances retirement and health benefits for the elderly and disabled, accounts for the vast majority of these contributions.

Corporate income tax has also increased substantially in the past five years or so and its share is approximately the same as the OCDE and EU average. Conversely, revenue from the personal income tax accounts for a smaller share of total revenues than in most other OCDE countries, as do property taxes.

The Portuguese tax system, which was created in its current form in 1989 (VAT was introduced three years earlier, in 1986, when Portugal was entranced to the European Union), aims to satisfy both the financial needs of the country and the income redistribution. About the aims of Portuguese tax system see, for instance, SANCHES, José Luis (2003); *Manual de Direito Fiscal*, Coimbra Editora, Coimbra; or CASALTA NABAIS, José (2003); *Direito Fiscal*, 2. ed., Almedina. Following the 1989 tax reform, tax bases were broadened and rates lowered, thereby reducing the economic costs of taxation.

The current tax system, however, has been criticised for a number of features, many of which are legacies of the past but which continue to add to the complexity of the system and make tax administration difficult.

According to the 1976 Constitution, the Portuguese fiscal system adopted a progressive income tax. However, while the legislation opted for a progressive taxation of labour income and pensions, taxation of many types of non-labour income instead was subjected to a flat rate which was withheld at source; different sources of income were subject to different effective tax rates.

At the same time, the numerous allowances and exemptions existent in the Portuguese fiscal system or inherited from previous regime add more complexity to the system and, consequently, make it more difficult for taxpayers to complain (BASTO, 2004, p. 16).

Furthermore, the distribution of income widened throughout the 1990s, putting the social and political acceptance of the tax system at some risk, which partly explain the long history of poor compliance (CDRF, 1996).

There have been some changes since 1998 till 2003 because some important fiscal laws were introduced. For example, some tax allowances were changed into tax credits, and a new general tax law and the Taxpayer Defender were introduced into the Portuguese tax system in order to improve the relations between taxpayers and the tax administration (BRONCHI; SANTOS, 2001).

However, Portuguese tax reform is again an important topic in political debate and is now, more than ever, at the centre of attention of the governments.

The bulk of this work will provide, therefore, an analysis of the main features of the Portuguese tax system. We will explain the basics of how the personal and corporate income taxes work, while at the same time identifying its main weaknesses.

3 GENERAL OVERVIEW OF THE PORTUGUESE INCOME TAXES

3.1 Basic features of the personal income tax

3.1.1 The Tax Base

A reasonable assumption is that the base of an income tax is income. However, most tax systems worldwide are not this simple and the Portuguese fiscal system is no exception (Albert Einstein is reputed to have said that the hardest thing in the world to understand was the income tax).

First of all, the Portuguese personal income tax (IRS) is levied on income derived by individuals resident in Portugal (including income from abroad) and by non-residents receiving taxable incomes originated in Portugal. The income is taxable in different ways depending on different sources and types of activity, which means that the methods for gross income determination and tax collection may vary according from category to category.

Therefore, there are six categories of income identified by letters from A to H. These ones include those incomes from dependent employment (A), self-employment, business and agricultural (B), capital (E), real estate (F), capital gains and winnings from gambling (G), and, finally, income from pensions (H) (Art. 1^o to 12^o of the Code of Portuguese Personal Income Tax – CIRS).

After the determination of the right and legal category of income tax, special deductions are made from gross income derived for each income category. For instance, employees can deduct 70% of the amount received without exceeding 72% of 12 time's national minimum wage, or the social contributions.

The social contributions are shared between employers and employees. The tax base for general employees is the gross salary and the rates vary first, for employees, between 10% for members of corporate boards and 11% for dependent workers and second, for employers, between 21,25% for members of corporate boards till 23,7% in other cases. To sum up the combined rate is 34, 7% and 31,25%, respectively. But we must indeed that for independent workers they can opt between two social security schemes at a rate of 25,4% for compulsory minimum coverage and at rate 32% for broader coverage. However, those who begin an independent activity at the age of 55 years or more can selected a tax base with a maximum limit of 6 x the minimum wage, if greater (Art. 25° of CIRS).

Also, the pensioners can deduct from gross income a fixed amount up to the maximum threshold fixed each year. Moreover, those pensioners who only obtain income from pensions not exceeding the year amount of domestic minimum wage are not obligated to fill out the tax return.

For category B, self-employment and business activity, the government was introduced since the year 2001 a simplified method for income determination, as a backstop to the erosion of the tax base caused by deductions and others preferences.

Therefore, the self-employment and business activity are levied, generally, on simplified method for income determination. The simplified method for income determination was introduced in the Portuguese fiscal system recently in the year 2001 with the aim of combat the evasion and avoidance in this category of income. This way of income determination is very popular in other European countries such as France, Spain, German and so on, an we usually call them “forfait regimes”, as France was the first country who had tried to impose the small traders and self-employment with simplified methods of income determination.

To more details about this subject see, for instance - OCDE (1994), which presume their deductions in 65% or 80% of the amount received respectively (Art. 28° to 33° of CIRS). However, they can also make an option for the accountancy regime, where they can deduct the expenses connected with the exercise of a professional activity or the costs effectively incurred, mostly subject to several limits.

The capital income (E) is taxed at significantly tax rates at source. With the main exception of rents from land and buildings, almost all of the income from capital accruing to individual savers is taxed under a separated flat-rate regime at statutory rates ranging between 0 and 25 percent, depending on the manner in which the income is invested and distributed to the final investor.

For the taxpayers who received income from real state (F) the deductions are only the repairs and maintenance expenses effectively incurred. And for the category of capital gains (G) only 50% of the net annual gain is taxable, although this rule does not apply to realised gains from the sale of financial assets.

In conclusion, the total personal taxable income is the sum of all income categories, although losses in one category cannot be deductible from credits in others categories; otherwise they can be carried forward for five years (Subjacent to this article is the non-communication principle between income categories to avoid probably losses of tax bases and consequently in the tax revenues collected by the Tax Administration - Art. 47° of CIRS).

3.1.2 The unit of taxation

Countries differ in the unit they use for income tax. The differences lie primarily in the treatment of married couples - We must say that choosing the tax unit is undoubtedly affected by the laws, traditions and social customs of a country and by its past history. Therefore, a country with a strong family and Roman Catholic tradition as Portugal or Spain for instance

treated married couples as a single unit, while in others where the family have not the burden in the society married couple is treated as two individual and different persons.

In some countries they are treated as a single unit while in others there is individual taxation and a married couple is treated the same as two single adults' - However, there maybe options, that means the married couple may choose to be treated as one unit or as two single adults (SANDFORD, 2000). Apart from this distinction, there is also the question of the treatment of minor children as part of the family unit.

Thus, in Portugal, the income of the spouses and their dependents is aggregated, and the tax is determined according to the splitting system, i.e., division of income by two before the application of personal income tax rate (BASTO, 1998, p. 36). The use of splitting system results in the tax liability of a married couple being generally equivalent to twice the amount payable by a single person with half the joint income. Consequently, the tax liability of married couples is at worst the same and in most cases less, than if they were charged as single persons.

However, nowadays, in Portugal there are some discussions between the policy-makers to move towards individual taxation. This attitude is in line with the enhanced position of women in the society as well as other groups such as homosexuals. As Sandford (2000) said there are several factors in favour of individual taxation mainly the decision to marry or not to marry ought not to be affected by tax considerations and also each taxpayer is entitled to privacy in relation to his or her tax affairs.

By comparison, the history of the United Kingdom's tax unit reinforces, significantly, the problems arising from choice of tax unit and the need to change that choice in line with changing customs - Prior to Second World War, under the United Kingdom income tax, husband and wife were treated as a single unit and their incomes were aggregated in determining the rate of tax.

The first major changes were brought about by the war because government wanted to encourage married women to go out to work, thus a cumulative PAYE was introduced to cope with the extension of population and some married womans' earned income relief. Since that time some little changes have been introduced such as the allowances for singles and married persons, but it was only after the year of 1990 that married income were taxable independently, as a result a husband's and wife's incomes are no longer aggregated (SOOS, 1997, p. 227), (KAY; KING, 1990).

To sum up we need pointed out that the greatest difficulty in choosing the tax unit is decidedly the reconciliation of two widely accepted but conflicting principles: equal treatment for all individuals irrespective of sex and marital status on the one hand, and, on the other, the recognition that the overall financial circumstances of a household are relevant to the ability to pay tax.

3.1.3 Tax rates

The Portuguese personal taxable incomes are subject to a graduated tax rate structure. This structure implies certainly a progressive taxation, i.e., the higher the income the larger the proportion of it taken in tax.

The following tables show the current range of statutory tax rates as well as the progressiveness in the Portuguese tax system and in others OCDE countries.

The Table 4 above illustrates the progressiveness of a Portuguese tax rate structure with different marginal (A) and average (B) tax rates as well as different brackets (Art. 68º of CIRS). Thus, the Portuguese income tax has seven rates that vary from 10,5% to 42%.

Table 4 – Tax rates in Portugal*

Taxable Income	Tax Rate	
	Normal (A)	Normal (B)
Up to 4451	10,5	10,500
4451 – 6732	13	11,3471
6732 – 16 692	23,5	18,5986
16 692 – 38 391	34	27,3037
38 391 – 55 639	36,5	30,1545
55 639 – 60 000	40	30,8701
Up to 60 000	42	-

* Cfr. Art. 68º of CIRS.

How does this rate structure work? To illustrate the underlying calculation, consider the example of a single person with 10 000 Euros of taxable income per year. Although this person is “in” the 23,5 percent bracket, his tax liability is much less than 23,5 percent of his total taxable income. Rather, he will pay 13 percent on his first 6 732 Euros and 23,5 percent on the remaining 3 268 Euros for a total tax bill of 1 643,14 Euros.

This calculation illustrates a critically important conceptual issue: the distinction between an average tax rate and a marginal tax rate. The marginal tax rate is the rate you pay on your next Euro of income, in the example 23,5 percent, whilst the average tax rate is your total tax bill expressed as a percentage of your income. On the whole, the average tax rate of this person is 1643,14 / 10 000, or 16,4% percent, significantly lower than 23,5% marginal tax rate.

Table 5 – Personal income taxation in selected OCDE countries

Countries	Portugal	France	Germany	Italy	Spain	UK	USA
Labour Income							
Range of rates (per cent)	10,5-42	10,5-54	0-53	18,5-45,5	15-39,6	10-40	15-39,6
Number of tax schedules	7	6	4	5	6	3	5
Tax rates on income capital							
Interest from bank	20	25	55,9	27	48	40	46,6
Dividends	15	61,2	55,9	12,5	48	40	46,6
Financial capital gains	0*	26	0	12,5	20	40	20

Source: BRONCHI, Chiara; SANTOS, José Carlos Gomes (2001); *Revenue Statistics 1965-2004*, Paris, p. 10.

* Capital gains resulting from the alienation of corporate rights (shares) and other marketable securities are liable to a 10 per cent withholding tax if shares are owned for less than twelve months. See Art. 10, n.º2, of CIRS.

As can be also seen the Portuguese current range of statutory tax rates is nearer to the United Kingdom and Spain than to other European countries.

However, the progressivity of the tax system is difficult to measure because it depends on what happens to average tax rates at different income levels. Actually, as Sandford (2000 p. 53) said “an income with a tax free allowance (which can be thought of as a zero rate) and just one positive rate is progressive and may be more or less progressive than a multiple rate system”. Moreover, to measure progressivity it is necessary to take into consideration the wide range of expressive tax deductions and credits which reduce effective progressivity in the personal income tax system.

For instance, in the Portuguese tax system in 1998 only 60% of the gross income declared by households was taxable and a large share of tax expenditures was concentrated on

taxpayers belonging to the highest income categories (BRONCHI; SANTOS, 2001). The reduction in taxable income was due to deductible expenses such as health, education and mortgage-interest expenses as well as to the benefit of retirement and housing saving accounts, acquisition of shares and so on.

3.1.4 Tax expenditures: deductions, tax allowances, credits and exemptions

The Portuguese personal code is structured with a wide range of tax expenditures. Tax expenditure is defined as an exemption or relief which is not part of the essential structure of the tax but has been introduced into the tax code for some extraneous reason such as to provide an incentive to develop a particular activity or a special behaviour in a group of taxpayers (Art. 1º of Portuguese Benefits Code).

The OCDE identifies and defines five categories of tax expenditure (OCDE, 1996). The first one is an *exemption* in which some or all income is excluded from the tax base, including gaps in the charge as well as specific exemptions. The second is *allowances* that are amounts deducted from gross income to arrive at taxable income. The *credits*, thirdly, are amounts deducted from tax liability. If the credit is not allowed to exceed the tax liability they are termed “wastable”, on the contrary, if any excess of credit over tax is paid to the taxpayer they are termed “non-wastable”. The *rate tax reliefs*, fourthly, exist when a reduced rate of tax is applied to a class of taxpayer or activity. Finally, when the reliefs take the form of an allowed delay in paying tax we will have tax deferrals - In this situation the cost to the Exchequer is the equivalent of the interest which has to be paid (or forgone) on the amount deferred for the period of the deferral. (SANDFORD et al, 1989).

We must say that all kinds of tax expenditures, which reduced the tax paid were the equivalent, in terms of revenue forgone, to direct expenditures by government and should be judged as such.

To improve the redistributive impact of the income tax, in 1999, some individual tax allowances were converted into tax credits, however their impact on the redistribution of income was not very significant.

As we have already said the determination of Portuguese personal income tax varies between categories and special tax allowances are deducted from gross income derived for each income category. In general, when we multiply the tax rate by the net income tax we will obtain the tax liability. After that, all the tax credits will be also deducted.

In fact, several expenses can be credited against the IRS tax liability such as Art. 80º to 88º:

- a) 30% of the expenses in health without any annual limit;
- b) 30% of expenses in education as well as cost incurred with homes for old-age care, with an annual limit;
- c) 30% of the expenses in personal insurance with annual restriction;
- d) 25% of the amount deposited in a saving account designated to finance the purchase, construction or restoration of primary residence with an annual limit;
- e) 25% of the contributions to private pension and education investment plan with an annual ceiling;
- f) 30% of expenses in renewable energy sources, with an annual limit;
- g) 30% of expenses incurred with tax advisers or lawyers, with limit.

In this stage, all the credits are wasteable and consequently no negative tax is refunded to the taxpayers.

3.1.5 Payment and withholding tax rates

The Portuguese personal income tax is paid annually on the basis of the household income tax return that must be submitted from February to April of the following year. Discharged from filing the tax return are only those persons who solely obtain income from pensions not exceeding the year amount of domestic minimum wage (Art. 8° of CIRS).

The Taxpayers residents who obtain income from employment as well as income from capital, self-employment, real state and commercial, industrial or agricultural activity, under certain conditions are subject to withholding at source at the rates provided by law. For example, the income from employment is subject at different and provisional tax rates, which are given each year by the government and which depend on the tax unit and the number of dependents (Decreto Lei n. 22/90, de 21 de Janeiro de 1990).

On the other hand, the income from self-employment, commercial, industrial or agricultural activity is subject to withholding provisional tax rates since 15% till 20% according to different sources (Art. 101° of CIRS). Once the income from capital has some relief, the tax rates became lower than the others ones. Therefore, the withholding varies from 10% on capital gains resulting of the sale of shares, quotas and other securities to 20% on deposits (Art. 74° of CIRS). In this case, most taxpayers can opt for or against the aggregation of capital income and as a result the withholding could be final or provisional (Art. 21° of CIRS).

In relation to the taxpayers non-residents, withholding is final and is levied on earned income and pensions (at a 25% rate), winnings from gambling (35%) and income from capital where the tax rate is variable according to type of income.

Apart from the withholding at source beneficiaries of earned income from self-employment or commercial, industrial or agricultural activity are required to pay three annual instalments, in July, September and December, whenever the tax exceeds certain limits (Art. 96 of CIRS).

Because of the withholding at source and the payments on account are in general provisional and non-wastable the taxpayers could benefit from refundable tax credit that is set off against the tax liability.

For obvious reasons, the fact that most Portuguese personal taxpayers receive a refund gives them a strong incentive to file their forms, which provides useful information for the Tax Administration.

3.2 Basic features of the corporate income tax

3.2.1 The tax base

The majority of businesses in Portugal are relatively small, and for most, their incomes are taxed directly under the personal income tax (CRF, 1996). But if owners of a business want both the full protection from legal liability that a corporation offers and the ability to raise funds by selling stock in the company to an unlimited number of shareholders, then they must form a traditional “Lda” or “SA” and became subject to the corporate income tax.

The Portuguese corporate income tax (IRC) is levied on corporate income earned by resident companies. Also, non-resident entities with a permanent establishment in Portugal are taxable on profits attributed to them or, if there is no such permanent establishment, on incomes from different categories, as such defined under the personal income tax (Art. 1° and 2° of Portuguese Corporate Income Tax - CIRC).

For the purpose of determining the taxable base, a distinction is made for resident entities with respect to whether or not they exercise as their main activity a commercial, industrial or agricultural activity. In the first case, (e.g. trading companies, co-operatives, public enterprises, etc.), IRC shall be levied on their profits. Otherwise, in the second case,

(e.g. associations and foundations) IRC charges the sum of income from different categories, as defined under personal income tax (Art.º 2 and 3º of CIRC).

To calculate the corporate tax base the resident entities who exercise their main activity in commerce, industry or agriculture can deduct all the costs incurred and deemed as absolutely necessary for the realisation of profits (Art. 17º to 2º of CIRC).

Thus, we can say that a corporation's net income for tax purposes is, in the most general sense, the proceeds from the firm's sales less the costs of doing business. The costs of many inputs to production are deductible in the year of purchase or when the items they produce are sold. These include wages, salaries, and benefits for employees, the cost of material inputs, costs of repair, advertising costs, and many other miscellaneous expenses. Deducting the costs of investment in durable equipment and buildings, however, is a bit more complicated.

The costs of investing in capital assets, such as productive machinery and buildings, are not deducted in full time of purchase. Instead, a depreciation deduction is employed - Depreciation is the decline in value of an asset, such as a factory or a machine, which occurs as the asset wears out or becomes obsolete. Actually, depreciation allowances are available for tangible and intangible assets that are used for business purposes. A company can deduct a portion of the capital asset's purchase price every year for several years until eventually the full purchase price is deducted.

Inventories cannot be depreciated; however, a tax deduction may be granted if at the end of a financial year the market value is less than the historic cost. Both straight-line and declining balance methods are allowed.

In relation to the deductibility of interest, if a company raises money for an investment by borrowing, the interest payments are generally deductible from the corporate tax base in the year they are made. Thus, business proceeds that are paid out in the form of interest escape taxation at the corporate level and, in turn, are taxed only once at the personal level.

The double taxation of dividends and capital gains in Portuguese tax system is attenuated by some mechanisms that eliminate or reduce totally the double taxation.

The corporate income that is distributed as dividends or capital gains is deductible by 100 percent from the corporate tax base, but only if the company partner has more than 95% of capital participation and more than 2 years of participation (Art. 45º of CIRC). Otherwise, if the company partner doesn't meet these conditions, only 50 percent of dividends are deductible (Art. 45º n. 7 of CIRC). This last method is in line with the other one adopted by personal income tax code (Art. 40º of CIRS/CIRC).

A credit is also allowed for taxes paid to foreign governments by Portuguese corporations. The principle here is to have Portuguese companies pay Portuguese tax, and only Portuguese tax, on all of their income regardless of the country in which the income was earned. This credit reduces tax liability by a certain percentage; however, most foreign governments offer symmetric treatment in their countries.

We also have a special regime for capital gains in case of reinvestment (Art. 45º of CIRC) in four years - The period fiscal is now two years before purchase the tangible asset and two years after his sell. In the past used to be three years after the sell of the assets.

To sum up, the tax base calculation we must recognize that losses for tax purposes can be carried forward for up to six subsequent fiscal periods (Art. 47º of CIRC). Due to the difficulty of assessing revenues and costs of small companies, the infrequent controls on companies' books and abusive tax-avoidance practices, roughly a third of Portuguese companies' present losses for tax purposes (see Table 6).

Table 6 - Companies presenting tax losses

Year	Total companies Number (1 000)	Companies with tax losses	
		Number (1 000)	In % of total companies
1996	233	92	39
1997	230	89	37
1998	248	85	34

Source: BRONCHI, Chiara; SANTOS, José Carlos Gomes (2001); *Revenue Statistics 1965-2004*, Paris, p. 17.

Because of these issues, the burden of corporate income tax falls on a very small number largely big companies. (see Table 7).

Table 7 – Corporate income tax revenues by company size

Number of companies	Corporate income tax revenues cumulative	
	Amount (Billion Escudos)	Percent of total
5 biggest	159	28
10 biggest	187	33
20 biggest	213	37
50 biggest	254	45
100 biggest	293	51
Total National	569	100

Source: BRONCHI, Chiara; SANTOS, José Carlos Gomes (2001); *Revenue Statistics 1965-2004*, Paris, p. 17.

3.2.2 Exemptions

There are several kinds of exemptions in the corporate income tax as in the tax base (objective exemption) as well as in the taxpayers (SALDANHA SANCHES, 2003).

Therefore, in the subjective exemptions the main entities that are exempt from the corporate tax are the State, regional and local administration, public social security and solidarity institutions (excluding capital income). The objective exemptions are, in general, agricultural and cultural activities as well as housing and social solidarity co-operatives and pension funds (Art. 8° to 15° of CIRC).

3.2.3 Special regimes

The Portuguese corporate income tax has a special fiscal regime, known as the Fiscal transparency regime, for some companies such as professional companies and complementary enterprise groupings (ACE's).

The fiscal transparency regime was introduced in the tax system for the purpose of neutrality, prevention of tax avoidance and elimination of the economic double taxation on profits between company members, under certain conditions. The profits shall be attributed to members thereof their share in profits, regardless of these being distributed or not (Art. 5° of CIRC). At the same time the profits of the transparent company are exempt from income tax (Art. 13° of CIRC).

3.2.4 Corporate tax rate

The Portuguese corporate tax rate is proportional. However, as a result of a range of tax relief and tax incentives for particular economic or social aims, the effective tax rate is much lower than the statutory rate. Recent estimates by the Ministry of Finance of Portugal based on macro data, show that the effective corporate income tax rate for the manufacturing sector as a whole was around 30% in 1998, some 5 percentage points below the statutory rate. Also, a comparative study for the EU finds that in 1998 the difference between statutory and effective corporate tax rates was the largest in Austria, Belgium and Portugal. The difference can be due either to more favourable depreciation and interest expenses deductibility rules or low enforcement of statutory rules. (BRONCHI; SANTOS, 2001).

A Proportional tax is one in which tax is proportional to income at every level. Portugal uses, since January of 2004, a statutory rate for corporate income tax of 27, 5% (25% plus 10% surcharge collected by municipalities). The last five years the corporate tax rate has been decreased from 39, 6% in 1998 to 27, 5% in 2004. The Portuguese government has been tried to be close to EU average and, at the same time, to will attract more foreign investment to the country. This attitude is in line with the tax reform of the eighties and early nineties years in the developed countries with developed tax systems. This tax rate is imposed only on profit obtained by resident entities exercising a commercial, industrial or agricultural activity as their main activity as well as a non-resident with a permanent establishment in Portugal. For resident entities exercising cultural or social activities, the corporate tax rate decrease, in turn, to 20%. Also a tax rate of 20% applies to small businesses with an average turnover below 150 million Euros.

Moreover, a 25% tax rate is levied on income obtained by non-resident legal persons and not attributable to a permanent establishment, except if derived from intellectual or industrial property, or from the supplying of Know-how (15%), from bonds and debentures and other income from capital (20%), or winning from gambling (35%).

In general, confidential or non-substantiated expenses, as well as entertainment expenses and motor vehicles charges, are taxed autonomously at 20% of tax rate of corporate income tax, i.e., 5% ($20\% \times 25\% = 5\%$).

3.2.5 Tax expenditures

As stated earlier, the effective corporate income tax rate is much lower than the statutory rate (We need to indeed that the effective tax rate is much lower than the statutory rate in a degree that is probably higher than the average tax relief in the European Union). The main reason for this difference is not only the wide tax evasion practices, but also the range of tax incentives.

In Portugal the major corporate tax incentives are provided on a regional and sectoral basis. They include investment tax credits, partial or total exemption of the tax base, lower statutory rates for micro-companies and companies operating in the region of the Azores, while entities registered in the free-trade zones of Madeira and the Azores are tax exempt.

The main beneficiaries are small and medium enterprises (SME), all resident entities investing in R&D (a feature common to most OCDE countries), undertaking large commercial and manufacturing projects or projects designed to internationalise the Portuguese economy, and also companies operating in financial markets.

We can see below the total of tax expenditures accruing to the corporate sector.

Table 8 - Tax expenditures in portuguese corporate sector

Incentives	Tax expenditure	
	Billion escudos	Per cent of GDP
Dividends from shares	7,6	0,0
Public debt interest	1,2	0,0
Investment incentives	9,0	0,0
SUB TOTAL	17,8	0,1
Free zone Madeira / Azores		
Temporary exemptions	28,8	0,1
Permanent exemption	162,9	0,8
Total tax expenditure	209,5	1,0

Source: BRONCHI, Chiara; SANTOS, José Carlos Gomes (2001, p. 17).

The Table 8 shows that corporate tax incentives cost the Portuguese budget too much money, particularly in the free – trade zones of Madeira and the Azores. Although these incentives have attracted an increasing number of new businesses to the regions, they do not

seem to have a proportional effect on the number of jobs, while large amounts of tax revenues, about 0,8 percent of GDP, were not collected in the year of 1998. Furthermore, policy makers have expressed worries about tax avoidance practices that emerge from the combination of these special tax regimes and inadequate auditing of inter-company practices such as transfer-pricing, thin capitalisation and controlled foreign companies.

In fact, as we know, anti-avoidance measures are usually difficult to apply because, for example, no market which assesses the price of inter-company transfers of goods and services exists, and therefore their application requires highly qualified and experienced tax-inspectors who, at present, do not represent the majority of tax inspectors in Portugal (BRONCHI; SANTOS, 2001, p. 17).

Because of anti-avoidance rules are incomprehensible for most taxpayers and is at the same time difficult for them to apply, which is definitely one source of complexity in the tax system (SLEMROD; BAKIJA, 2000).

In conclusion, tax incentives, which are equivalent to tax expenditures, can be used to correct market failures faced by specific sectors or disadvantages regions. However, to be efficient they require precise and clear definition and tight attention, which are both very difficult to achieve since they may distort resource allocation as well as introduce complexity in the tax system.

3.2.7 Payment and withholding at source

The Portuguese corporate income tax is paid annually, on the basis of tax return and payable, as a general rule, upon submission of the tax return.

Resident entities exercising as their main activity a commercial, industrial or agricultural activity, as well as non-residents with a permanent establishment must pay IRC on three instalments based on 85% of the IRC paid in the previous year, the difference will be set upon delivery of the annual tax return of the subsequent year.

In relation to withholding at source that one has the nature of an advance payment and has the same rates as personal income tax withholding taxes. For income paid to non residents that are not a permanent establishment, the withholding tax is final, with the exception of income from real state

4 COMPLEXITY AND ENFORCEABILITY IN THE PORTUGUESE TAX SYSTEM

The first two sections have presented some main features of the Portuguese tax system, in particular the income taxes that should be helpful as an introduction to analyse critically some aspects of our tax system such as complexity and enforceability in the last years.

Based on the above analysis, the Portuguese tax system has important flaws that introduced complexity, which surely have implications for enforceability.

Therefore, in this part we will explain and discuss the main aspects that make the system complex and difficult to enforce. We will begin by examining just the economical issues that have been introduced complexity and then we will look at administrative and legislative complexity in the tax system.

4.1 Economic issues and complexity

Based on the above analysis, the tax/GDP ratio in Portugal seems to be in line with other countries. Furthermore, the fact that the system is significantly biased towards indirect taxes, with 36,4 percent of total tax revenue, compared with 30 percent on average in the OCDE, this bias can be a positive feature from an economic perspective, given the better neutrality and efficiency of consumption taxes by comparison with income taxes - The

consumption taxes would reduce investment distortion, because it would abolish the “tax wedge” between the return on the physical asset and the rate of return the saver receives. This distortion is not uniform. For example, with a progressive tax it depends on the marginal tax rate of the taxpayer and varies with any relief which may be accorded to particular forms of saving, like home ownership or pension contributions (SANDFORD, 2000).

However, the system has important flaws which have significant complex implications. Firstly, as we said above, the Portuguese tax system has the same level of statutory rates on income bases as in the majority of OCDE countries, although average rates are generally low when measured in effective terms, because of relatively narrow tax bases. In fact, Portuguese income tax is surrounded by allowances and credits that are generally aimed at social, cultural or economic purposes; however, it is unclear whether these objectives are achieved in the most efficient way, because, in many cases, they only add complexity to the tax system. Moreover, tax expenditures have inherent disadvantages over direct expenditures as instruments of policy (SANDFORD, 2000). Their cost in terms of revenue forgone is more difficult to estimate because the value of the subsidy to taxpayers is indeterminate. Also, they do not enable the same degree of agency discretion as direct programs do, largely because they are provided automatically and are not means-tested.

We must also say that incentives, in general, complicate tax administration and tax system, increasing compliance costs as well as tax evasion and avoidance. Thus, we think that tax incentives in Portugal should be limited to a strict minimum and only provided in areas, such as generic R&D and training (BASTO, 1994).

To sum up the Portuguese tax system will succeed if policy makers re-evaluate and reduce allowances and credits in income taxes codes. This would broaden the personal and corporate tax base and would likely eliminate some market distortions resulting in a simpler and more efficient system (BASTO, 2004).

Secondly, the presence of a separate incentive regime for the free-trade zone of the regions of Madeira and the Azores also represent a further distortion within Portuguese corporate tax system and should be phased-out to minimise incentives for tax-planning by companies or investors that are in a position to choose between these regimes. Once again, the potential base-broadening of corporate income tax would make the system more neutral by reducing the existing rate differentiation in favour of both small companies and autonomous regions; it would also reduce tax avoidance incentives and could improve enforcement.

Thirdly, wide differences in the tax treatment of various sources of income can significantly distort economic choices and erode allocative efficiency.

In general, the tax system favours activities undertaken by self employment since, as in other OCDE countries, they are more difficult to tax and can under report business profits with low probability of sanction. Besides the profits forgone, this creates a sense of unfairness among taxpayers that may lower the degree of social and political acceptance of the tax system and increase non-compliance. Portugal’s tax base is especially exposed to this problem because the number of self-employment and small businesses is large and enforcement has been lax. The Ministry of Finance has no estimate of the degree of compliance among the self-employment, but we suppose that the level of under-declared income is likely to be high. For example, in 1998, dependent workers and pensioners, who account for three-quarters of taxpayers, contributed 90 percent of personal income tax revenues. Almost all independent workers (99,6 percent) were able to keep simplified accounting books for their transactions and operations and 18 percent of the total presented negative returns (BRONCHI; SANTOS, 2001).

In order to combat this problem, the government introduced a simplified regime in 2001 budget. According to this simplified income regime, independent workers and business activities are subject to a minimum taxable income based on coefficients fixed by law. In

comparison with self assessment income, the minimum taxable income has the advantage of a simplified the tax system, keeping a fixed amount of tax revenues as well as improve the enforcement (The presume methods of calculation income tax base are present in all the Europe, such as regime forfait, in France, versamento unificato, in Italy, or, last, modulos regime, in Spain).

Fourthly, another source of economic distortion is the presence of different forms of capital income which are taxed at different rates. This distortion arises from two principal sources: The personal income tax rate levied on different forms of income from capital and the extent to which these earnings are subject to corporate income taxation.

Almost all of the income from capital accruing to individual savers is taxed under a separate flat-rate regime at statutory rates ranging between 0 and 15 percent, depending on the manner in which the income is invested and distributed to the final investor.

For instance, interest payments from both bank deposits and bonds are taxed at a flat rate of 20 percent, being fully deductible from the base of corporate income tax. Financial capital gains, which are taxed at 10% (or exempt if shares are held for more than twelve months) at the level of the individual, are among the most favoured forms of passing profits. In contrast the taxation of dividends that are distributed is considerably high and depend on the form that the dividend takes before arriving in the hands of the individual shareholder or in investment fund. On the whole, such disparities tend to affect both the allocation of capital and firms financing decisions.

Last, but not least, is the bias in favour of debt finance that the Portuguese tax system shows. As with most OCDE tax systems, Portugal favours debt finance, since corporate interest payments-in contrast to distributed profits- are deductible from the corporate tax base and this heavily penalises new equity finance (BRONCHI; SANTOS, 2001, p. 29).

As we see in this part of the study, the Portuguese tax system contains some particular features and economic distortions which increase complexity such as opportunities for tax-expenditure abuses, discouraging tax compliance and making tax collection inefficient.

4.2 Administrative complexity and compliance

The most informative measure of tax complexity is the resource cost of collecting taxes. Different costs arise from the existence of the tax system.

The administrative costs, which are the costs incurred by revenue department, are not the sole component in the total costs of collection. This brings us to the question of tax compliance costs, the costs which taxpayers incur in order to comply with the tax law. Administrative and compliance costs together can be termed tax operating costs (SANDFORD, et al., 1989, p. 3).

In this part of the study we will start by examining the costs to Portuguese government to collect taxes as well as taxpayers' compliance with the tax system. We will also look at attempts to compare these costs across countries. Special emphasis is given to a number of the main technical features of the Portuguese tax system which are likely to give rise to fiscal complexity.

4.2.1 Administrative costs

The most evident administrative costs are those incurred by the revenue departments in collecting the tax revenue, e.g. wages and salaries of revenue staff, accommodation (including rents, cleaning), postage, telephone, printing, travel, equipments costs as computing and so on.

This definition of administrative costs has the advantage of according closely with the costs attributed to the revenue departments. Almost all the developed countries usually keep

the detailed components of expenditure as a matter of routine. Consequently, it is possible to do international comparisons.

A measure is used sometimes to compare the performance of tax administrations, either as a time series for a particular country or between countries, is usually the ratio of administrative cost to tax revenue, which can be used for one tax or tax system as a whole.

This ratio is, therefore, very often used as an indicator of Inland Revenue efficiency (GODWIN, 1979, p. 20).

The Table 9 below shows this ratio for ten countries. Therefore, we can compare Portuguese Inland revenue efficiency with the others ones OCDE countries.

Table 9 – Comparison with overseas tax authorities

Countries	Ratio = Costs Inland Revenue/ Fiscal Revenues
Sweden	0,42%
USA	0,52%
Spain	0,78%
Ireland	0,95%
United Kingdom	1,15%
Canada	1,20%
France	1,44%
Italy	1,52%
Portugal	1,68%
Germany	1,71%
Netherlands	1,76%

Source: OCDE, L'administration fiscale dans les pays de l'OCDE, 2004; Série «Informations comparatives», Paris, p. 74; European Union, Summary Internal Working Document, 2001; Learning Lab on the Cost of Tax Management Following the Meeting of 1 October, p. 20.

The Table 9 shows a variation in Inland Revenue efficiency from 1,76 percent, in Netherlands, to 0,42 percent in Sweden. For the purpose of comparisons, we can divide the countries into three groups. The first group, Sweden and USA, includes the most efficient tax administrations, with costs under approximately 0,50 percent of tax revenue. The second group comprising Spain, Ireland, United Kingdom, Canada, and France incurred costs of about 1,00 percent of tax revenue, which are in line with the average in the sample above presented. Finally, the third group comprising Italy, Portugal, Germany, and, Netherlands, with costs above 1,5 percent of tax revenue (However, In Portugal, this ratio has been decreased considerably, from 1,8 percent in 1997, to 1,5 percent in 1998, to 1,6 percent in 1999, to 1,6 percent to 2000. European Union, Summary Internal Working Document, Learning Lab on the Cost of Tax Management Following the Meeting of 1 Oct. 2001, 20 pp).

These kind of international comparisons are made frequently, particularly by tax administrators; however, contemporary tax literature dealing with cost of collections ratios highlights the limitations of such comparisons when assessing overall efficiency and effectiveness (SANDFORD, 2000).

In fact, international comparisons of any statistical data are notoriously difficult to undertake because of the difficulty in getting data from different countries on a reasonable standard conceptual basis. Also, demographic, political, social, economic, legal and government factors can significantly affect elements of the cost of collections ratio. Indeed, one of the major limitations in comparing cost or revenue ratios, between countries or in the same country over time is that administrative costs in isolation are only one part. They take no account of tax compliance costs (SANDFORD, et al., 1989; SANDFORD, 1995).

4.2.2 Compliance Costs

As Sandford (1973) said, compliance costs are the costs over and above actual tax payments and over and above any distortion costs inherent in the tax or in tax system.

For personal taxpayers they include the time taken to complete tax returns and store and retrieve the necessary tax data, the payments to a tax adviser or tax preparer and miscellaneous costs such as transport to visit a tax adviser or the tax office. In turn, for businesses compliance costs may arise from taxes on the product, the profits or the employees and include the costs of learning legal obligations, and of collecting, recording and remitting tax to the authorities.

Together, the administrative and compliance costs may be termed “operating costs”. The operating costs are the total real resources taken up in running the tax system, which is the important concept from the standpoint of the economy as a whole.

Adam Smith was the first economist who recognised the importance of compliance costs in the *Wealth of Nations*, 1776. After Smith, however, the subject was largely neglected and no serious attempt to measure tax compliance costs was undertaken until 1930 (HAIG, 1935). Thereafter studies of compliance costs generally were small scale or lacking in rigour until 1970, but the period since then has seen an increasing number of high quality studies, such as Sandford et al. (1989), in United Kingdom, Slemrod et al. (1987), in United States of America, and Vaillancourt (1987), in Canada. Nowadays the number of studies grows world wide.

However, in Portugal no estimates of compliance costs of taxation have been made yet. Therefore, international comparisons made above of administrative costs have little meaning because we have considered them in isolation from compliance costs. And even when administrative and compliance costs are considered together, there are a factors affecting either or both of them which need to be taken into account before one can consider the aspects, structure, and administrative features of the tax systems.

Above, in the first part of the study, we outlined same administrative, technical, and economic features of Portuguese tax system, which make the system more complicate to enforce.

In fact, Knowing that the tax system is complicated is one thing. It is also important to understand exactly what makes the Portuguese tax system complex if we want to simplify it in order to decrease administrative and compliance costs (LOPES, 2003).

A number of measures have been implemented in the past few years to enhance the performance of Portuguese tax administration and at least improve enforceability (BRONCHI; SANTOS, 2001).

The changes made to improve tax administration include, for instance, the unification into one register of separate direct taxes (excluding social security contributions) and VAT (which has facilitated the introduction of a tax identification number and its association to the taxpayer’s address), the introduction of an automated taxpayer database system (RITTA, 1996), and also measures specifically aimed at enhancing taxpayer services, such as the Virtual Tax Office, which permits access to a wide number of services online.

A new supervisor body, the General Tax Administration - The main purpose of this body is to co-ordinate auditing, training and the strategic planning of the three general tax directorates (Directorate General for Taxation - DGCI), Directorate General for customs and excise taxes (DGAIEC) and Directorate General for Information Assistance to Taxation and Customs Services (DGITA). At the same time, the internal organisations of DGCI and DGAIEC were radically changed from a tax-specific structure (personal incomes taxes, corporate taxes, consumption taxes) to a functional structure (assessment, collection, auditing, taxpayer services and tax justice). This follows the approach adopted in several other OCDE countries (BRONCHI; SANTOS, 2001, p. 29). Was created in 1999 and the structure of the overall tax administration was completely reorganised with the aim of improving tax administration.

The Tax Training Institute has been reformed and training now provides tax inspectors in new areas of taxation and customs policy as well as in the planning of information systems. For example, about 2000 highly-qualified tax employees have been hired, of which 250 are tax inspectors.

Finally, recently approved changes include partial easing of bank secrecy for tax purposes. Although these changes are already achieving results, several deficiencies are still in place.

First, the number of tax inspectors with expertise to tackle difficult international cases, such as those related to transfer-pricing and thin-capitalisation practices, is insufficient and also a large number of corporate profits remain untaxed. Second, auditing resources are substantially concentrated on bigger companies. Third, there is still no cross-checking between income taxes and social security registers. Also, the tax court trials are very slow while tax evasion is much faster. Finally, in the last few years, the Portuguese tax system has been subject to frequently revisions and tax addendum, which contribute to increasing the legislative complexity.

All of these features together significantly discourage tax compliance as well as make tax collection inefficient.

4.3 Legislative complexity

The Portuguese tax system has imposed unnecessary increases of legislative complexity on taxpayers as a whole. The complexity of tax system depends on the increase and uncertainty of tax legislation (LOPES, 2003).

The Portuguese tax system has known five important tax reforms in the twentieth century, which further complicate system. The volume of fiscal legislation has been increased as well as the extent of uncertainty in their interpretation. The extent of this uncertainty is just one indicator of the tax system's complexity. Another is the sheer length of the tax code.

For example 2001 edition of Portuguese corporate income tax includes 71 385 words, 375 410 characters, 445 170 characters with spaces, 8226 rows and 2973 paragraphs (www.agt.min-financas.pt). In turn, the Personal Income Tax Code, includes 48 396 words, 259 275 characters, 306 462 characters with spaces, 2841 paragraphs and 6344 rows (www.agt.min-financas.pt).

We also did the same exercise for consumption taxes, in particular for the VAT (LIMA, 2000), the 1987 edition includes 655 pages, the 1995 edition 1194 pages and, finally, the one of 2000 1439 pages.

The Table 10 below points out the number of pages and articles that had been introduced during the last tax reforms (LOPES, 2003).

As can be seen in table above, the volume of fiscal legislation has been increased during the Portuguese tax reforms. Moreover, recently the tax law is subject, every year, to frequent and several revisions and amendments that have not simplified the system. It can be difficult for both tax administration and taxpayers. On one hand, it is decidedly difficult for the tax administration to maintain constantly update tax system, which consequently elicits the complaints of taxpayers. On the other hand, it became more difficult for businesses and citizens to identify the full requirements of the law, resulting in low compliance.

In order to simplify the tax legislation several initiatives have been made from several countries. For example, in United Kingdom a Tax Law Review Committee (1995, p. 71) was created, in 1995, with the purpose of simplifies and re-writes English tax law in comprehensible and easy English (GAMMIE et al., 1993).

Table 10 – Points out the number of pages and articles that had been introduced during the last tax reforms

TAXES* INCOME TAX 1922**	N.º PÁGES	N.º ARTICLES
-Industrial Contribution	4	12
-Capital Taxes	3	11
-Personal Income Tax	6	33
1929***		
-Industrial Contribution	6	33
-Capital Taxes	1	11
-Professional Income Tax	4	22
-Complement Income Tax	2	5
1960/70		
-Industrial Contribution (Portugal, Decreto-Lei, n. 45103, 1963)	28	165
-Capital Taxes (Portugal, Decreto-Lei n. 44 562, 1962)	16	100
-Capital Gains Taxes (Portugal, Decreto-Lei n. 46 373, 1965)	11	67
-Professional Taxes (Portugal, Decreto-Lei n. 44 305, 1962)	15	85
-Complement Taxes (Portugal, Decreto-Lei n. 45 399, 1963)	30	161
1989****		
-Corporate Income Tax (Circ) (Portugal, Decreto-Lei n. 442-B/88, 1988)	52	115
-Personal Income Tax (IRS) (Portugal, Decreto-Lei n. 442-A/88, 1988)	50	141
-Fiscal Benefits Code (Portgal, Decreto-Lei n. 215-/89, 1989)	19	55
-Fiscal Penalties (RJIFNA) (Portugal, Decreto-Lei n. 20-A/90, 1990)	12	58
CONSUMATION TAXES		
1922-Transation Tax (Portugal, Lei n. 1368, 1922)	4	9
1929-Transation Tax (Portugal, Decreto-Lei n.º 16 731, 1929)	4	9
1960/70-Transation Tax (Portugal, Decreto-Lei n.º 47 066, 1966)	32	134
1986-Value Add Transation (VAT) (Portugal, Decreto-Lei n.º 394-B/84, 1984)	54	125

* To make the table easier to read as a result we can do better comparisons, we have built the table with the original information published in the original Law. Therefore, the articles above are those in the original Law as well as the number of pages is in line with the number of columns in the same Law.

** Lei n.º 1368, *Diário da República*, N.º 197, I Série, 21 de Setembro, 1922.

*** Decreto-Lei n.º 16 731, *Diário da República*, N.º 83, I Série, 13 de Abril, 1929.

**** The information in the table is not completely comparable on the whole. Actually, the main innovation of tax reform in 1989 was the change from a system based on taxes schedulers to a system with global income taxes.

On the whole, transparency and reliability of the Portuguese tax system should be further improved, while giving priority to a lower frequency of tax changes. Consequently, we can promote a higher degree of tax compliance.

5 CONCLUSIONS

Overall, it is important to summarize some main points:

a) The Portuguese tax burden is not high by international comparison with other OCDE countries as well as European countries.

b) The biggest source of tax revenue in Portuguese tax system is the consumption tax and the second biggest is the contributions to social insurance. The personal income tax is below the OCDE average whilst the corporate income tax, although it has been increased in the past years, is above the OCDE average;

c) According to the 1976 Constitution, the Portuguese fiscal system adopted a progressive income tax. However, while the legislation opted for a progressive taxation of labour income and pensions, taxation of many types of non-labour income was subjected to a flat rate withheld at source, consequently, different sources of income were subject to different effective tax rates;

d) The Portuguese personal taxable incomes are subject to a graduated tax rate structure. The current range of statutory tax rates is nearer to the United Kingdom and Spain than to the others European countries;

e) To measure the progressivity of tax system, it is necessary to take into consideration the wide range of tax allowances and credits which reduce effective progressivity in personal income tax;

f) The numerous allowances and exemptions existent in the Portuguese personal tax or inherited from previous regime add more complexity to the system and, at the same time, make it more difficult to complain;

g) The majority of businesses in Portugal are relatively small and the burden of corporate income tax falls on a very small number of companies almost the big ones;

h) The corporate tax rate is proportional. However, as result of a range of tax relief and tax incentives for other purposes such as economical or social aims, the effective tax rate is much lower than the statutory rate as seen in personal income tax rate;

i) The major corporate tax incentives are provided on a regional and sectorised basis. They include investment tax credit, partial or total exemption of the tax base, lower statutory rates for micro-companies and companies operating in the free zones of Madeira and Azores are tax exempt;

j) The existence of these special regimes leads to tax avoidance practices of companies such as transfer-pricing, thin capitalisation and controlled foreign companies;

k) The anti-avoidance rules are, in general, incomprehensible for most taxpayers and difficult for them to apply and as a result these rules are decidedly another source of complexity for the tax system;

l) Therefore, tax incentives should be limited to a strict minimum. This would broaden the income tax base and could possibly eliminate some market distortions and as a result in a more simple and efficient system;

m) To be efficient, tax expenditures require precise and clear definition, which is very difficult to achieve, otherwise they may distort resource allocation, discourage tax compliance and make tax collection inefficient;

o) The measure used to compare the performance of tax administration is the ratio of administrative cost to tax revenue, which is very often used as an indicator of Inland Revenue Efficiency. Portugal presents one of the highest ratio in OCDE countries;

p) However, international comparisons are difficult to undertake because many factors, such as demographic, political, social or economic, can significantly affect elements of cost of collections ratio. Also, administrative costs take no account of tax compliance.

q) In Portugal no estimates of compliance costs of taxation have been made yet;

t) A number of measures have been implemented in Portuguese tax system to improve compliance and performance tax administration such as a new supervisor body as well as 2000 new highly qualified tax employees, of which 250 are tax inspectors, easing of bank secrecy for tax purposes and so on;

u) Despite these changes, several deficiencies still exist, such as the low number of tax inspectors with the expertise to tackle difficult international cases, the large number of corporate profits that remain untaxed, the slowness of tax court trials combined with the rapidity of tax evasion, and, finally, the increase of revisions and tax addendum, all of which considerably contribute to the complexity of the system;

v) Legislative complexity has been increased during the Portuguese tax reforms since the volume of tax legislation and the extent of uncertainty has also been increased.

x) To sum up, as Portugal can not afford to reduce taxes without reconsidering expenditure, the main options for a revenue tax neutral reform should include transparency and reliability while giving priority to a lower frequency of tax changes.

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