The new treaty provides for a 5 percent withholding tax on cross-border interest and royalty payments, except for interest payments on bank loans and some other payments, which will be tax exempt. The new treaty also includes the real estate company clause. The treaty entered into force on May 25 and takes effect January 1, 2011.

Protocols

New protocols to the existing income tax treaties with Denmark and Switzerland were signed in 2010.

Tax on Civil Law Transactions

On January 22 amendments to the Law on Tax on Civil Law Transactions/Capital Duty were passed. They clarify the scope of exemption from the tax regarding the sale of financial instruments, adjust the tax treatment of transactions performed by nonresident entities, and clarify the tax's application to agreements establishing a company.

Commission v. Poland (C-311/09)

On May 6 the ECJ ruled that Poland violated articles 73, 168, and 273 of Council Directive 2006/112/WE on the common system of value added tax. The case concerned a Polish ordinance dated April 27, 2004, implementing the VAT law dated March 11, 2004. The ordinance introduced simplified lump sum VAT taxation of entities performing international passenger transport by buses registered in countries other than Poland.

VAT

On October 26 the government approved measures aimed at reducing the deficit. They will take effect January 1, 2011, and will increase the VAT rates from the current 22 percent (general rate), 3 percent (unprocessed food), and 7 percent (food, newspapers, fertilizers, personal hygiene items, and firefighting equipment) to 23 percent, 5 percent, and 8 percent, respectively.

Income Taxes

On October 29 the lower chamber of parliament passed several amendments to the 1991 Personal Income Tax Law, the 1992 Corporate Income Tax Law, and the 1998 Law on Lump Sump Personal Income Tax. They focus on taxation of in-kind contributions to companies and partnerships.

♦ *Janusz Fiszer is a partner at White & Case in Warsaw and an associate professor at the Warsaw University School of Management.*

Portugal

by Francisco de Sousa da Câmara and Andreia Gabriel Pereira

Portugal introduced several measures in 2010 aimed at stabilizing the economy, controlling the deficit, and decreasing public debt. They were relatively mild compared with the more aggressive rules that were later enacted. Many observers regret that some of the reforms took so long to be adopted, given that subsequent treatment was harsher than necessary.

Following a year of slowdown in 2009, the economy showed no signs of improvement in 2010. The financial struggles of other EU states took center stage and forced the Portuguese government to recognize that the only option was to impose new and more severe austerity measures.

This article outlines the austerity package and other measures targeted at corporate directors. As of year's end, only a few attractive tax regimes remain, providing for some competitiveness in an otherwise gloomy tax environment. The remaining favorable tax regimes include the Madeira International Business Center, the treatment of expatriates under the new regime for "nonhabitual" residents, and contractual tax incentives for specific investments.

The 2010 Budget

The 2010 budget created a special tax at the company level for bonus payments. (For prior coverage, see *Tax Notes Int'l*, Feb. 8, 2010, p. 507, *Doc 2010-2372*, or *2010 WTD 22-1*.)

A 35 percent tax applies to expenses resulting from bonuses and other variable remuneration paid to managers, directors, and administrators when the payments are more than 25 percent of the payee's annual remuneration and exceed €27,500. There is an exception when the payments are subject to deferral for a minimum of three years and relate to positive performance of the company during that period.

A separate tax of 50 percent applies to expenses resulting from bonuses and other variable remuneration paid in 2010 by credit institutions or financial companies to managers or directors when those payments exceed 25 percent of the payee's annual remuneration and are higher than €27,500.

As a result of pressure from the European Commission, a new withholding tax exemption was enacted for dividends paid by a Portuguese company to a company located in a European Economic Area member state that is subject to administrative cooperation in taxation. Previously only companies of EU member states could benefit under the EU parent-subsidiary directive.

AP Photo/Armando Franca

In November tax office workers protested the government's austerity measures outside the Portuguese parliament.

Austerity Packages

In March the government presented its stability and growth program for 2010-2013. (For prior coverage, see *Tax Notes Int'l*, Apr. 5, 2010, p. 39, *Doc 2010-6552*, or *2010 WTD 58-1*.)

A new personal income tax rate of 45 percent was introduced for taxpayers with annual taxable incomes exceeding €150,000. The previous maximum rate was 42 percent for taxable incomes exceeding €64,110. A new, uniform 20 percent tax applies to capital gains of individuals. Previously those gains were either taxed at a 10 percent rate or were exempt from taxation (for instance, on the disposal of bonds, debt securities, or shares held for more than 12 months).

A few months later, those measures were deemed insufficient and another austerity package was approved. This time the measures were more comprehensive and included:

- a VAT tax increase, setting new rates of 1 to 6 percent for necessities, 13 percent for restaurants, and 21 percent for most other goods and services;
- an increase in the corporate income tax rate to 27.5 percent for companies earning more than €2 million per year;
- a reduction in the salaries of high-level government officials;
- an increase in personal income tax rates of between 0.58 and 0.88 percentage points, leading to a maximum individual income tax rate of 45.88 percent; and
- a 1.5 percent increase in personal income withholding tax rates.

The 2011 Budget Bill

The recent budget bill for 2011 was controversial because it proposed additional tax increases. The Socialist government lacks a majority in parliament and struggled to reach agreement with the largest opposition party, the Social Democratic Party, but eventually reached a solution that averted a budget crisis.

Across-the-board tax increases and public spending cuts were the two themes of the budget that hopefully will allow Portugal to meet its international and EU

commitments. The fiscal measures are expected to steady the bond market, allow for the restoration of confidence in the Portuguese economy, and drive down the government's cost of borrowing.

The bill provides for the most stringent austerity measures to date, including amendments to corporate and personal income taxes and VAT. The bill would increase the standard VAT rate from 21 percent to 23 percent. It would widen the individual tax brackets and tax interest income on shareholder loans at a flat rate of 21.5 percent, rather than at progressive rates. (For prior coverage, see *Tax Notes Int'l*, Nov. 15, 2010, p. 489, *Doc 2010-23921*, or *2010 WTD 215-3*.)

The bill would change the corporate income tax regime by eliminating the 50 percent dividend exclusion on qualifying intercompany dividends. It would impose a new charge on Portuguese credit institutions and Portuguese branches of nonresident credit institutions. It would impose supplementary restrictions on the deductibility of bad debts and provide relief for reinvestment of capital gains on share transfers. It would also introduce limitations on the use of tax losses within corporate groups if the profits consist of previously untaxed intercompany dividends.

Another controversial proposal is the establishment of a salary reduction of between 5 and 10 percent for state workers with monthly salaries exceeding €1,500.

Only time will tell if the new austerity measures for 2011, plus the efforts in 2010, will prove sufficient — or if Portugal will become the latest country forced to request assistance from the IMF and the EU. In terms of austerity tax measures, it's impossible for the country to go much further.

♦ *Francisco de Sousa da Câmara and Andreia Gabriel Pereira are with Morais Leitão, Galvão Teles, Soares da Silva & Associados in Lisbon.*

Russia

by Maureen O'Donoghue

2010 was an eventful year regarding the Russian tax treatment of loans. Few other developments have had such a broad impact on taxpayers as those regarding the deductibility of interest. While some long-anticipated legislative changes have failed to materialize, major changes were announced and enacted in what seemed like a matter of days.

New Limits on Deductibility Enacted

One of the most significant and unexpected amendments enacted this year[1] was a change to the general limits on the deductibility of interest. The goal seems to be to encourage greater use of rubles by making loans in other currencies less tax efficient. (See table.)

Taxpayers may choose an alternative basis for calculating deductible interest based on the deviation from the average level of interest charged on comparable loans. However, comparable loans may be unidentifiable in practice. The loans must have been issued in the same tax accounting period (either a month or a quarter) and in the same currency for the same periods in comparable amounts against similar collateral.

The Recognition of Interest Expenses

A key concern this year was how the tax authorities would respond to the controversial precedent established in a newly published decision of the Presidium of the Supreme Arbitration Court (Decision 11200/09 of Nov. 24, 2009). The presidium ruled that it was improper for the borrower to have deducted accrued interest in 2005 and 2006 given that no payments would be made until later.

In March the tax authorities began clarifying the issue. The Ministry of Finance and the Federal Tax Service agreed "that interest on debt obligations must be accounted for throughout a loan agreement's period of validity, regardless of the agreement's terms with respect to the settlement date for amounts of interest accrued for the [loan's] period of use." Tax inspectors were told to continue applying the position adopted before Ruling 11200/09 until the Ministry of Finance issued clarifications.

Thin Capitalization

The thin capitalization rules were introduced in 2002. The original wording restricted deductions for interest arising on indebtedness to foreign companies that directly or indirectly owned more than 20 percent of the shares in a Russian borrower. Effective starting

[1]By Federal Law 229-FZ of July 27, 2010.