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# Portugal Draft Budget for 2018

# The Draft Budget 2018

- On the 13th of October 2018 the Draft Budget for 2018 was presented;
- This is a draft document at this moment in time which will now be discussed and likely be subject to amendments until the publication in its final form, which is expected to happen by the end of November;
- As is known, the Portuguese Government comprised of the socialist party (PS) is supported in Parliament by a coalition of leftwing parties. Therefore, the 2018 budget can be seen as a serious effort at achieving a compromise between the various interests at play between these parties. Whilst it is natural that some changes will occur between the draft and the final versions of the document, it is expected that the majority of the proposals will be converted into final legislation. This is because this draft document already was discussed in detail by all the parties in the coalition and, therefore, the majority of the proposals represented points that these parties could agree on.

# Highlights on the economy

# Portuguese Economy in 2017

The draft budget makes it clear that the good news on the Portuguese economy continue, namely:

- Forecast 2,6% GDP growth in 2017, decreasing to 2,2% in 2018. It should be noted that one year ago the forecasted growth rate for Portugal was 1,8%, which means that the economy grew much faster than what was initially predicted. Whilst the growth in the economy comes from various sources, there are no doubts that the main engines of growth continue to be investment, exports and, especially, tourism;
- The unemployment rate continues to fall, with the forecasted rate for the end of 2017 being 9,2%, dropping to 8,6% in 2018. This is the best result since the start of the financial crisis in 2008.

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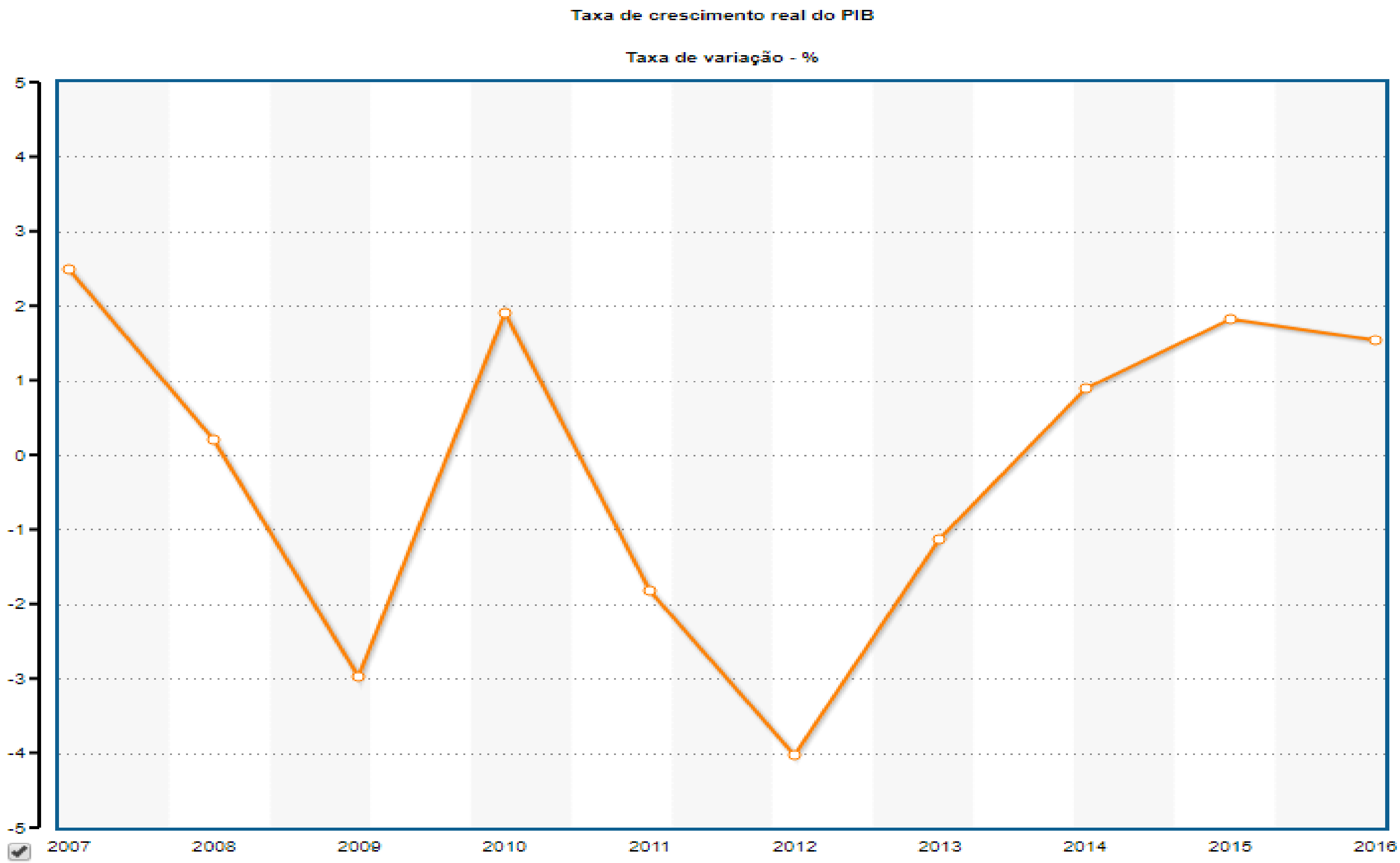
| **Economic highlights** | • **2,6% GDP growth in 2017**<br>• **2,2% GDP growth in 2018**<br>• **9,2% unemployment in 2017**<br>• **8,6 unemployment in 2018** |

# Portuguese GDP growth (2007-2016)

## Current rates of GDP growth should be put in context with that of previous years



# The Portuguese economy in 2017

- The <u>deficit</u> for 2017 should end at 1,4%, and is forecast to continue dropping in 2018 to 1%. One of the main drivers of the drop in the deficit is the lowering of the interest costs on public debt, being around €730m lower than was forecasted at the beginning of 2017. The drop in the deficit to 1,4% should be put in the context of noting that the 2014 deficit was 7,7% of GDP!;
- Average salaries continue to increase, exports rose significantly in 2017 and are expected to continue rising in 2018;
- Tourism keeps breaking records and the country's investment in high-end tourism seems to be paying off.

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| Economic highlights | • 1% forecasted deficit for 2018<br>• Average salary levels projected to increase 2,2% in 2018;<br>• Rise in exports of 8,3% in 2017. |

# Portugal: a Tourism awarded country

In 2016, the Algarve had over 16 millions of overnight stays, representing 37,2% of all stays of tourists in Portugal.

- Portugal is, nowadays, the usual suspect concerning to tourism-related prizes, specially by the *World Travel Awards*:
  - Europe's Leading Beach Destination on the years of 2012, 2013, 2014 and 2016; Europe's Leading Tourist Board on the years of 2013, 2014, 2015 and 2016; World's Best Golf Destination on the years of 2016 and 2013; And is also nominated (the Algarve) to the next World's Leading Beach Destination 2017.
- Projected 12m tourists in 2017 (by international arrival), Around 10% year on year increase;
- Tourism is becoming more year round, and higher quality;
- However, Portugal still not very touristic country by international standards – so scope to grow???

# Portugal: Tourism industry

- Portugal has less tourists than Austria, Croatia, Poland, Greece or Hungary. And, at 11m tourist arrivals in 2017, it only has a fraction of Spain's 68m international tourist arrivals.
- In 2016 tourism was a USD$14bn industry in Portugal.

Portugal is not in top 10 tourist countries in Europe. No destination in Portugal is in top 25 in the world.

It seems that there is still a significant room for growth in this sector and 2017 is set to break all previous records in terms of number of tourists , spend per tourist and average number of stay.

| Year | Number of tourists by international arrivals | Year on year change | International tourism receipts |
|---|---|---|---|
| 2010 | 6 832 000 | 11,8% (2014/2013) | USD$10,1bn |
| 2014 | 9 277 000 | 9,3% (2015/2014) | USD$ 13,8bn |
| 2015 | 10 140 000 | 12,7% (2016/2015) | USD$12,7bn |
| 2016 | 11 423 000 | 12% (projection for 2017/2016 change) | USD$ 14bn |

# Portuguese Economy in 2017

It is therefore probably fair to say that the mood in Portugal is of cautious optimism:

- “**Optimism**” because the economic numbers are undoubtedly positive.
- “**Cautious**” because the recovery from the crisis cannot and should not be taken for granted, and steps should be taken to consolidate the gains verified over the last year.

# Highlights on the main tax changes

# Tax changes in Portuguese draft budget

**Summary**

Whilst the draft budget introduces a number of proposals and changes to the Portuguese tax legislation, only a small amount of significant changes were proposed. In fact, this budget is clearly one of continuity with the economic program of the Government which is a mixture of fiscal rectitude and a key focus on the easing of austerity through tax reductions wherever possible. Where tax reductions are made, a key effort was put into ensuring that the measures are redistributive.

# Key highlights on the changes proposed

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| **Tax highlights** | • Reduction in income tax rates for the lower income population with changes to the tax bands meaning a significant part of the population will end up 2018 with a lower tax rate compared to 2017;<br>• Elimination of the "sobretaxa" which was an additional income tax rate;<br>• Portuguese non-habitual resident tax regime remains completely unchanged, contrary to expectations;<br>• Introduction of new benefits for the rehabilitation of properties, in addition to the ones that were already in existence;<br>• Changes to the simplified income tax regime may significantly increase the taxation of certain income sources, namely the income derived from short-term rentals, certain consultancy income, and others;<br>• The introduction of a Portuguese right to tax on the sale of non-Portuguese companies the assets of which are mainly comprised of Portuguese real estate;<br>• Introduction or increase of scope of incentives to the capitalization of companies and to the conversion of debt into capital. |

# The NHR regime and international investment

**International investors**

One of the biggest surprises was the fact that the Portuguese non-habitual resident tax regime (NHR) has stayed <u>completely unchanged</u>. In fact, prior to the publication of the budget several news items were circulated which stated that this tax regime which, as is known, is a very beneficial tax regime that has attracted thousands of individuals to Portugal over the last few years, would be amended for those making new applications, in what regards the tax treatment of foreign pension income.

In the end the final Budget proposal is silent on this matter, and **no changes to the NHR regime** are proposed.

All other features of the Portuguese legislation that have been key to attracting foreign investors (the Golden Visa regime; participation exemption; tax efficient investment vehicles; etc.) have been maintained and no major changes were announced.

# Other tax changes

From a **corporate tax** perspective, the proposed changes are relatively modest, with **no significant legislative changes** having been proposed.

**Key proposed tax changes**

The **Portuguese income tax** regime may suffer a significant change in what relates to the **simplified regime** which applies to certain categories of income not exceeding, on an annual basis, €200 000.

- For these types of income the progressive tax rates are currently applied on a pre-determined percentage of the income.
- Under the new regime, these set percentages will become the maximum permitted deduction with taxpayers having to present corresponding invoices to be able to claim the deductions.

# Other tax changes (cont.)

**Key proposed tax changes**

Furthermore, the legislator has introduced a requirement, within the corporate tax and income tax codes, that the gains on the disposal of companies the assets of which are comprised, in 50% or more, of Portuguese real estate, are Portuguese sourced-income, meaning that these gains will always be taxable in Portugal, irrespective of where the seller is located. These two new articles introduce, in effect, a **non-resident capital gains tax**, where **Portuguese real estate** is indirectly sold via a non-Portuguese company and is in line with the proposed OECD changes that will be introduced via the Multilateral Convention, although it goes beyond what is proposed by the OECD in this respect.

# Other tax changes (cont.)

**Key proposed tax changes**

Finally, it should be noted that the Government proposed a number of additional tax incentives to promote the rehabilitation of properties. These incentives are quite significant and are inserted within Portugal's strategy to ensure that the vast majority of real estate construction work is carried out via the rehabilitation of properties rather than new building.

There are a number of other changes that were introduced to the Portuguese tax legislation, however these are changes of detail which may not be relevant to international investors seeking to invest or relocate to Portugal.

# Conclusions

**Key points to note**

- Portugal is undoubtedly going through a good economic period, with political stability despite an unprecedented configuration of the Parliament and ruling parties;
- In this second budget the Government strikes what is an interesting balance between fiscal discipline and the easing of austerity;
- The easing of austerity has been achieved in a very redistributive way, with reduction of income tax rates having been made, especially significant for the lower income population;
- From a tax perspective, some changes were proposed, although not hugely significant. It was, from a tax perspective, also a budget of continuity, which is important from the perspective of foreign investors and economic players in general;
- No changes were proposed to the main programs that have been promoting foreign investment in Portugal.

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