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Personal Income Tax: Comprehensive or Dual?
A Comparative Study of the Portuguese and Spanish Systems

Tendências na tributação da renda pessoal: abrangentes ou dual? Um estudo comparativo dos sistemas portugues e espanhol

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RESUMO

Os sistemas de tributação da renda pessoal estão mudando rapidamente em todo o globo. Portugal e Espanha paráram o território da Península Ibérica durante séculos e as suas economias são intensamente interligados. No entanto, eles adotaram sistemas de tributação da renda pessoal diferentes. Portugal introduziu em 1989 um sistema abrangente ou unitário que segue as tendências de tributação vigentes em muitos países europeus baseado no conceito de rendimento acumulado. Os diferentes tipos de rendimentos são tributados em conjunto, normalmente a taxas progressivas. Mais recentemente, muitos países europeus evoluíram para sistemas semi-duplas tributação para adaptar a tributação sobre a renda pessoal aos desafios da globalização, off shoring e desintermediação. (Brys, 2014) A Espanha adoptou um modelo de sistema dual. A pesquisa aponta as vantagens e desvantagens de cada modelo, comparando as soluções adotadas nos países ibéricos, Portugal (que cobre imposto de renda abrangente) e em Espanha (que tem um imposto de renda semi-dual). Defendemos que Portugal deve adotar o imposto de renda semi-dual, porque este revela-se melhor ajustado para as necessidades do público em relação aos desafios da mobilidade do capital, as necessidades de atração de investimento estrangeiro, e o aumento da concorrência fiscal entre os estados, devido à globalização económica. O imposto de renda semi-dual é um simplificado modelo de imposto de renda pessoal e acaba por ser mais competitivo a nível internacional.

Palavras-chave: Imposto de renda pessoal, imposto de renda abrangente, imposto de renda dual, imposto de renda semi-dual.

JEL: K0, K42

ABSTRACT

The personal income tax systems are changing rapidly around the globe. Portugal and Spain share the territory of the Iberian Peninsula for centuries and their economies are intensively interconnected. They have however adopted different tax personal income systems. Portugal introduced in 1989 a comprehensive or unitary system that follows the taxation trends prevailing in many European countries based on the concept of accrued income. The different types of income are taxed together, normally at progressive rates. More recently, many European states have evolved towards semi-dual taxation to adapt taxation on personal income to the challenges of globalization, offshoring and disintermediation. (Brys, 2014) Spain has adopted a dual system model. This research points out the advantages and disadvantages of each model by comparing the solutions adopted in the Iberian countries, Portugal (which levies comprehensive income tax) and Spain (which has a semi-dual income tax). We argue that Portugal should adopt the semi-dual income tax because it reveals better adjusted to the public needs concerning the challenges of capital mobility, the needs of attraction foreign investment and the rise of tax competition between states due to economic globalization. The semi-dual income tax is simplified personal income tax model and turns out to be more competitive internationally.

Keywords: Personal income tax, comprehensive income tax, dual income tax, semi-dual income tax.

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1. Introduction

Personal income taxes are far from residual taxes in modern tax systems. On the contrary, these taxes are the best known tax instruments to perform the distribution of income and achieve the so-called social justice. Under these general aspects, there isn’t only one model of taxation of personal income.

This research aims to compare the personal income tax models used in Portugal and Spain. The main goals are: (1) to establish the fundamental characteristics of each system; (2) to describe the solutions adopted for the different types of taxable income in personal income tax of each country; and (3) taking account the greater mobility of capital and the public need to attract investment and tax competition between states, due to economic globalization, (4) to verify which model meets better the challenges of capital mobility, the needs of foreign investment and the rise of tax competition between states due to economic globalization. Finally, some suggestions will be made for the improvement of the Portuguese income tax model that would prove to be maladjusted in relation to the new economic conditions.

2. Theoretical Frameworks - The Initial Reform Process

The Portuguese personal income tax reform in 1989 established the unity principle of income, which subjected all personal income to a table of progressive tax rates. This principle derives from Article 104 (1) of the Portuguese Constitution, which states: “The aim of personal income tax is to reduce inequalities. It will therefore be a single tax and take account of households’ needs and income”.

Up to the 1989 tax reform, which introduced the Personal Income Tax Code (CIRS), there was a schedular system of taxation. Under the new model, personal income partially conforms to the principle of unity and progressivity of personal income as stated in the Portuguese Constitution, since this new broadly based income tax system does not follow its pure formula. Certain categories of income are exempt from taxation or are subject to definitive or special flat rates and are not aggregated with other revenues. The departure from the unity model is justified by arguments of tax competition, administrative simplification and difficulty in controlling taxpayers. Throughout the twenty-three years changes have been made to the original tax model, justified by the need to adjust it in order to generate more revenue, solve some shortcomings of equity and reshape income categories. These changes did not follow international trends in personal taxation, based on dual and semi-dual tax base models.

This divergence appears to reflect negatively on the competitiveness of Portugal in a globalized economy. Today, some advocate the need to adjust income tax in order to generate more revenue, eliminate exemptions to solve some equality issues and reshape income categories. Others call for deeper changes to follow the trends in personal tax at international level and the adoption of dual or semi-dual tax base models in the name of competitiveness in a globalized economy.

However, the adoption of a dual based system in Portugal involves dividing the tax base which, according to some authors, could cause constitutionality problems, (Morais et al., 2009) (De Basto, 2007) and (Canotilho & Moreira, 2007).

The various theoretical positions reveal concerns about economic development, tax competition, attraction of investment and tax simplification, all fundamental to boost our economy and thereby create more jobs and thus more tax revenue, particularly in Portugal’s current circumstances.
3. Types of Personal Income Tax Systems

There are different models used to tax personal income. The differences between them lie in the elements that comprise the tax base, the number of bases and the tax rate: a flat rate or different progressive rates based on the source of income. The choice between models is based not only on political reasons, but also and mainly on economic factors and tax competition between states. In order to prevent the transfer of capital revenue to countries with more favourable taxation regimes, countries tend to segregate revenue by nature by applying different tax rates to each type of income or granting exemptions to stem the outflow of capital revenue.

3.1. The Comprehensive Income Tax

Comprehensive or unitary tax system is based on accrued income, which follows the Schanz-Haig-Simons definition. (Faustino, 2015) According to this model, the tax base includes all income accruals whether they have been realized or not, plus the value of consumption in the taxation period. Net income from all sources is added together and is subjected to a single, progressive table of rising marginal tax rates. Income must be measured in real terms, with appropriate inflation adjustment of nominal returns on capital, and all capital gains must be taxed and losses deducted, whether they have been realized or not (Sørensen, 2010).

Then, there is no differentiation in treatment between capital and labour income as they are both subject to the same table of tax rates, which eliminates any incentive to taxpayers to artificially transform one kind of income into another, since both pay the same marginal tax rate. (Faustino, 2005)

Although many tax systems have been inspired by this income definition, administrative difficulties in this model have meant lead that no country actually uses the Schanz-Haig-Simons definition of comprehensive income (OECD, 2006). Most countries that have adopted a tax system based on this model, do not take account of unrealized accrued income. Several weaknesses have been pointed out in this model, e.g. that it violates the horizontal equity principle as it discriminates some kinds of income against others. Also, because it does not take account of the specific nature of certain revenue, like capital income, given its great mobility, it is more susceptible to tax evasion as it is easily moved across borders to jurisdictions with lower taxation. (Owens, 2008)

3.2. The Dual

The dual system is a creation of the Nordic countries. It was first introduced in 1987 in Denmark, followed in the early nineties by other countries in the region, such as Finland, Norway and Sweden. Various reasons underlie the emergence of this model, such as "[...] to eliminate some distortions in the taxation of corporate profits and still continue to use personal income tax for the purpose of redistribution" (Morais, 2009, p. 218).

Its main characteristic is the division of income between capital income and that from other sources, building two bases. Capital and corporate income are taxed at a proportional rate. This flat rate is equal or close to the marginal tax on the lowest bracket in the table of progressive rates applicable to all other sources of income.
The choice of a lower proportional tax rate on capital income is based, among others, on the following arguments (Sørensen, 2010): Capital mobility: Establishing a lower tax rate on domestic capital income reduces the risk of capital flight and the preference of taxpayers to shift their source of income to foreign low-tax jurisdictions; Tax neutrality: Certain types of capital income for practical or political reasons are hard to tax. Lower rates of taxation applied to these revenues makes it possible not only to reduce the distortions caused by their exclusion from the tax base, but also makes it easier to broaden the tax base, for instance by including capital gains without causing severe lock-in effects; Lock-in effects: Capital gains taxation based on the realization principle may give rise to gain retention, which hampers the optimal reallocation of resources. Progressive taxation of realized gains exacerbates this lock-in effect, because the taxpayer may be pushed into a higher tax bracket in the year of realization. A low flat tax on capital income limits this effect; Tax arbitrage: Aligning the corporate with the personal tax rate on capital income and equalizing marginal capital income tax rates across taxpayers eliminates the scope for them to exploit the differences in tax rates in their favour; Clientele effects: For taxpayers in high-income brackets, capital taxation at a progressive rate may lead to holding assets in order to benefit from tax deferral, which can have undesirable effects.

In order to be as neutral as possible, the capital income tax base should be as broad as possible and so it must include all possible forms of capital income, such as interest, dividends, capital gains from capital and real estate, rents, royalties, imputed return to owner occupied housing and imputed returns on capital invested in non-corporate firms (Sørensen, 2009). The labour income base includes wages and salaries, pensions, social security transfers and fringe benefits. The expenditures incurred to obtain it are deductible from gross income in this base. Progressive rates are levied on net income.

Under this model, income from business activities, when the entrepreneur works in his own business as a manager, consultant, or employee, has to be divided into two components: labour and capital income. This division assumes that income from self-employed work comes directly from the work and from return on invested capital. As this income has two components, it must be broken down into two parts for the purpose of applying the regime and tax rate. A basic dual system would be consistent with the model shown in Table 1, in which the tax rate (30%) on corporation and capital income is equal to the lowest bracket in the table of progressive tax rates.

<table>
<thead>
<tr>
<th>Dual income</th>
<th>Labour income</th>
<th>Wages</th>
<th>Pensions</th>
<th>Other income</th>
<th>Progressive tax</th>
<th>Minimum exempt</th>
</tr>
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<tr>
<td>Capital income</td>
<td>Interest</td>
<td>Capital gains</td>
<td>Dividends</td>
<td>Other capital revenue</td>
<td>Flat tax</td>
<td>Flat tax: 30%</td>
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<tr>
<td>Corporate tax</td>
<td>Capital income</td>
<td>Profit Interest</td>
<td>Capital gains</td>
<td>Flat tax</td>
<td>Tax: 30%</td>
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**Source:** Adapted from Sánchez and Rodriguez (2004:105)³

In Norway the bases are as follows: A broad general base that includes all types of income, net of tax deductions, subject to a flat tax equal to corporate income tax. In 2012 the flat rate was 28%; A progressive tax rate on wages and pensions in addition to the flat rate, by means of surtax on gross income from wages and pensions above a certain threshold. In 2012, the surtax was 12%.⁴ According to Sørensen (2010), one of its weaknesses is the application of a lower uniform flat tax to all capital income. This allows individuals with higher labour income and therefore subject to higher taxation to transform it into capital income for lower taxation. It would not happen if it was considered as labour.

There are political decisions in the implementation of the dual model that can make changes in its conception, in particular when levying the proportional tax rate on capital income. The choice is between a proportional tax rate on all capital income or only a part of capital income called "normal" (Sørensen, 2010).

### 3.3. The Semi-dual Income Tax

The semi-dual tax system is a variant of the comprehensive or dual income tax system, as no country uses pure comprehensive or a pure dual income tax. (Faustino, 2005) It is not a new model, but rather one that fits some of the characteristics of both, thereby building a new base. According to the OECD (2006), tax systems based on this model levy different tax rates on different types of income depending on their nature. In general, capital and corporate income are taxed at low flat rates and the remaining sources of income are taxed at higher, progressive rates.

The personal income tax model in the Netherlands is an example of semi-dual taxation. Since 2001 the Netherlands has had three tax bases. Each base called "box", groups several types of income to which a proportional or progressive tax rate applies. The main features of the system are:

- **Box 1:** includes wage income, income from self-employment, pensions, social security transfers and income from owner-occupied property, less personal allowances, deductions of childcare expenses and other specific deductions.
  - Net income is taxed at progressive rates in a four-bracket scale ranging from 33.1% to 52%.⁵
    - In the first two brackets the rate is a combination of tax and National Insurance Premium (31.5%). In the first bracket the tax rate is 1.95%, while in the third and fourth bracket, we have only tax.

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• **Box 2**: includes taxable income from shares, such as dividends or capital gains, if the shareholder directly or indirectly controls at least 5% of the share capital.
  ○ Net income is taxed at a proportional rate of 25%.
• **Box 3**: includes savings income such as interest, dividends from shares whose shareholder have a holding of less than 5%, capital gains from investments in real estate, bonds and other capital income and investments in financial assets.
  ○ A proportional rate of 30% is applied on a notional return of 4% on the net value of the assets owned by the taxpayer.

For 2012, corporate income tax is progressive, with two levels: 20% up to €200,000 and 25% after that. This system is not a pure dual system as capital income is subject to different tax rates. Capital revenue included in Box 2 is taxed at the highest tax rate on corporate profits. However, this is half the rate for higher personal income in box 1, which encourages taxpayers to convert labour income into capital income.

The aim of this box system in the Netherlands was to broaden the tax base, replace tax deductions with tax credits and wealth tax and taxation on individual capital income with taxation of income from capital invested. Personal income tax of this nature ensures that all forms of taxpayers’ personal income are equally taxed. This prevents taxpayers from realizing capital income in the form of capital gains exempt from taxation, as was allowed by the previous tax system (OECD, 2006).

The main change occurred in taxation of capital income. The solution used by the Netherlands to tax personal income has its critics, mainly because it includes presumed income and not just real income. The way taxpayers are taxed and the rate levied have also attracted criticism because they violate vertical equity.

### 4. Methodology

In this part of the study we define the choices for this research, supported by the theoretical discussion introduced. We recall the purpose of study and we will hold us in the adopted research design justification that will focus on research of the considered tax.

#### 4.1. Research Aim and Starting Point

This paper aims to study the Portuguese and Spanish personal income tax systems. Portugal has a comprehensive personal income tax system, Spain has adopted a semi-dual tax system. The main goal is to establish a relationship between these two central realities: the fundamental characteristics of each system and describe the solutions adopted for the different types of taxable income in personal income tax of each country.

This relationship is underpinned by the objective of, at first, to describe the regularity of a particular phenomenon (Blaikie, 2000) that in our specific case involves to describe the personal income tax systems in both countries. Thus, it is intended to characterize the solutions adopted for the different types of income subject to each personal tax system. The choice is based on the fact that tax systems are increasingly sensitive to globalization and international tax competition. Thus, they tend to lose stiffness featuring unitarian systems and to adopt different tax solutions depending on the nature of the income.
In the European case this sensitivity is even greater because most member states (including Portugal and Spain) are part of an economic and monetary union which makes their economies more open to each other and to the outside. The starting point is: which model has the best features to meet the increasing mobility of income and the international tax competitiveness. This study consists of a theoretical part and a practical part. In the theoretical part features the income tax system of each study subject country. In the practical part compares the solutions adopted and determine the advantages and virtues of each model.

4.2. Research Design and Selection of the Object

Based on the initial question and the object and purpose of the study, we use the case study called research design. This design is appropriate when the studies have starting questions such as: What, which one or how? (Yin, 2009, p. 8). According to the author this research design does not require a control of events and focuses on contemporary events, soon will be duty meet the external validity (which aims to connect the tool used for data collection and the conceptual approach used) (Bryman, 2004).

We have selected a specific type of reality: the personal income tax in Portugal and Spain. This option is justified by the restrict number of studies on the evolution of these realities whose social, political and economic contours are very important to understand which model has the best features to cope with the increasing mobility of personal income and the international tax competitiveness.

The authors are experts on taxation. Thus, the specific models of personal income tax in each country will be analytically assessed. The different tax bases are characterized as well as the respective specific allowances. Armed with this information the method of direct comparison of the technical solutions adopted in each model will be used to extract conclusions. This method was used specifically in the summary table 2.

4.3. Sources and Data Collection

Data collection was done by two ways: at first through the existing documentation files (Hood, 2011) and consultation of succession applicable law in each country. According to Yin (2009), these sources have the great advantage of being stable because they can be constantly updated; are not obstructive because they don’t result from previous studies; are exact result because the law or the data provided by the tax authorities of each country about the social phenomenon being studied.

We have accessed to the Portuguese and Spanish databases available on the Internet, which contains all the legal and judicial developments, the justification and the available data (Hood, 2011). Thus it is thought that any weaknesses on the sources were cancelled. (Pollitt, 2010). The validity of the information is assured and data submitted to attest to the development of the phenomenon under discussion are reliable. At the end we built up a comparative table of the tax models in place in Portugal and in Spain.
5. Portuguese Personal Income Tax (IRS)

5.1. Background and Features

Prior to the 1989 tax reform, personal income tax was a schedular-type system. It consisted of many different taxes on real estate, commercial and industrial activities, labour and capital. There was a progressive supplementary tax on this personal income. The 1989 tax reform delivered better efficiency, equity and simplicity (Morais, 2008).

The tax reform’s main concerns were (Pitta & Cunha, 1989): horizontal equity, seeking equal treatment for taxpayers with similar income levels, to the detriment of vertical equity, expressed by the rate of progressivity; efficiency, aiming to encourage savings and investment and ensure taxation of fringe benefits and simplification, seeking to put an end to opacity of the rules and limit the difficulties arising from interpretation of the law. The core of the new personal income tax was its unity based on comprehensive and customized taxation of personal income, a broad definition of income (accrued income) and an important set of expenses and deductions that took account of specific taxpayer situations, like marital status and number of dependents, subject to a single table of progressive rates.

5.2. The Nature of the Portuguese Personal Income Tax (IRS)

Portuguese Personal Income tax (IRS) is a direct, personal, progressive tax. Its purpose is to tax all income earned by taxpayers in a given period of time, including revenue from illegal acts. All residents in Portugal are subject to IRS on their worldwide income. Non-residents are taxed only on income obtained in Portugal. For households, the tax is levied on the aggregate income of their members. The real target of personal income tax is the net income of individuals whether or not they belong to a household, calculated from gross revenue in the different categories of income, minus the expenses necessary to obtain it.

5.3. The Structure of IRS

Personal income tax enshrines a schedular design comprising six categories of income: A, B, E, F, G and H, according to their nature or source of income. The law provides for allowances or deductions for gross income in each category in order to turn it into net income, which may or not be aggregated. These deductions are intended to reflect maintenance costs of the production source, so that the tax is not levied on the portion of income required to earn it. However, sometimes full deduction of all costs incurred by the taxpayer is not possible, undermining the principle of effective taxation according to the ability to pay principle that supports the taxation of net income, according to which only net income is suitable for the payment of taxes (Morais, 2008) and (Nabais, 2010).

6. The Analytical Phase

It is in the analytical phase that net income is calculated from the gross income in each of the six categories listed in the code, by applying specific deductions to gross income. Specific deductions
are the necessary expenses permitted by law for the production of income or maintenance of the productive source.

6.1. Determination of Net Income

In category A, employment income, net income is calculated by a fixed allowance. According to De Basto (2007), this deduction was the solution found by law to overcome difficulties in defining what expenses are incurred by taxpayers during their activity as employees, without introducing arbitrary discrimination, given the difficulty in determining them.

The specific deduction for each taxpayer is 72% of 12 times the value of the Social Support Index (IAS), which may be increased to 75% of 12 times the IAS, or be equal to the value of the mandatory contribution to social security systems and health subsystems, when exceeding that value (Article 25 of the CIRS – Portuguese personal income tax code).

In category B, business and professional income, taxable income is determined by the simplified scheme or on the basis of organized accounting (Article 28 of the CIRS).

In category E, capital income, no deductions are provided for. In real estate income, category F, duly documented maintenance expenses, condominium expenses and Municipal Property Tax (IMI) (Article 41 of the CIRS) are deductible. These deductions have no limit and a net loss may be calculated. Generally, in category G, net worth increases, no deductions are accepted, except for income from capital gains which is allowed to deduct certain costs and expenses incurred with the assets (Article 43 and 51 of the CIRS).

In category H, pensions, a fixed amount of €4,104 may be deducted for each taxpayer (Article 53 (1) and (2)). For pensions above €22,500, there is a reduction of 20% on the difference between the pension earned and €22,500 (Article 53 (5)). Each taxpayer may also deduct a union fee up to a limit of 1% of gross income in this category plus 50%, and social security and health contributions on the part exceeding the deduction under Article 53 (1) and (5).

7. The Synthetic Phase

In this phase, the net income of all categories is aggregated, which may not match the taxpayers’ total income. For taxpayers residing in Portugal the aggregation of the following net income is mandatory: Category A, B, C, H, E and G (in the latter two categories, income taxed by definitive or special taxes is excluded from mandatory aggregation. Nevertheless, some of them may, be taxed together with all other revenues at the taxpayer’s request). Taxable income, such as income from undivided estates (Art. 19 of the CIRS) - the earnings of companies subject to the tax transparency scheme (Article 6 of the CIRC) and profits of non-resident companies subject to the preferential tax scheme (Article 20 of the CIRS). Articles 71 and 72 of the CIRS (definitive and special taxes) list the types of revenue whose aggregation is not mandatory (Article 22 (2) of the CIRS).

7.1. Tax Deductions

Aggregate net income is subject to the general tax rates under Article 68 of the CIRS, thus obtaining tax payable. Progressive taxation can work in different ways. In the IRS the progressive table of general tax rates is based on income levels. For 2012 the tax brackets and rates vary from 11.5% to 46.5% for revenues up to €4,989 and above €153,300. This tax rate for married taxpayers
or equivalent is levied by means of the "splitting" system (Article 69 of the CIRS). Taxpayers may deduct from their payable tax certain expenses, which take account of the taxpayer’s personal circumstances. The consideration of personal-type deductions is based on a fixed amount, called "subsistence level", and allowances for taxpayers and their families and for disabled individuals, and tax credits, health expenses, health insurance premiums, education and training expenses, nursing homes, life and personal accident insurance premiums, alimony payments and housing expenses and tax benefits, contributions to retirement savings funds and plans, donations and the public capitalization scheme (Articles 70, 78 and 79 to 88 of the CIRS). The "subsistence level" is a limit to the application of general tax rates and abides by the principle of ability to pay. It sets a material limit on taxation for which no one should pay taxes. It was this consideration and socially relevant expenditure incurred by the taxpayer that fulfilled the provisions of Article 104 of the CRP that requires household needs to be taken into account in personal income tax (Morais, 2008).

8. Spanish Personal Income Tax (IRPF)

8.1. Background and Features

The Spanish tax reform that began in 1977 introduced Impuesto sobre la Renta de las Personas (IRPF) with Law 44/1978 of 8 September. The comprehensive model was structured around a progressive rate. Most earned income was subject to this tax regime. This model has undergone several reforms, influenced by endogenous and exogenous factors, such as economic globalization, tax competition between states, high mobility of capital and economic pressure groups and others that have made amendments to the initial model.

These, according to Gonzalez (2007), distorted the neutrality of financial investments as until 2006 the IRPF structure provided for different treatments for them, thus exerting a negative influence on their tax returns.

The Spanish comprehensive tax system was already semi-dualized by the fact that there were two taxation bases, the general and special base. The special base included capital gains when held for a period of over one year, which were subtracted from progressive taxation. They were then taxed at a proportional rate of 15%, lower than that levied on other sources of income, whose maximum rate could reach 45%.

In 2006/2007 the comprehensive tax system underwent reforms that made important changes to its organization, making it a semi-dual tax system (Ministerio de Economía y Hacienda, 2010).

This reform was part of an international evolution in trends for personal income tax. The amendments deepened the measures implemented in previous reforms and solved some of the problems introduced by them or not considered until then (Míguez, Sánchez, Sáez, Sanz & Pérez, 2006). In addition to finding a solution to these problems, the 2007 tax reform introduced measures to simplify and reduce of administrative costs, stimulated economic growth and productivity and took account of taxation of the aging population by implementing protective measures for older taxpayers (Míguez, et al., 2006).

The main innovation is the introduction of a dual taxation model, which established two bases of taxable income (Article 6 (3) of the IRPF): The general base; The saving base.

These two taxation bases should not be confused with the different categories of income subject to personal tax listed in Article 6 (2) of the IRPF, as follows: Employment income; Capital
income (movable and immovable); Income from business activities; Gains and losses in equities; Other earnings provided for by law.

With this separation, taxpayers’ income is subject to the rules for each tax base for the purpose of calculating tax. All individuals who have their habitual residence in Spain, including those who, while residing abroad, should be considered resident in Spain pursuant to Article 10 of the IRPF, are subject to personal income tax. Including those who change residence to a tax haven for tax purposes, this presumption applies not only to the year in which the change is made, but also to the next four years (Article 8 (2)). The IRPF uses the broad concept of accrued income.

8.2. The Saving Base and Tax Rates

According to article 46 of the IRPF, this base comprises two components: Revenues from movable capital (Article 25 (1) to (3) of the IRPF); Gains and losses generated in the transmission of equity. Until 2009 revenue included in this base was taxed at a flat rate of 18%. The tax was changed in 2010. The income is now taxed at two levels at the following rates (Articles 66 and 76 of the IRPF): Taxable income up to €6,000 - 19%; Taxable income above €6,001 - 21%.

Equal treatment for all revenue from capital assets and capital gains produced by the transmission of equity values neutralizes people’s investment options in their decision to save or invest. It makes personal tax more transparent and contributes to higher economic efficiency by increasing competitiveness between financial instruments. The time factor in taxation of capital gains has been eliminated, i.e. the lock-in effect has been removed.

8.3. The General Base and Tax Rates

This base comprises the following revenue: Income from employment, pensions and intellectual property (Article 17 of the IRPF); Income from business (Article 27 (1) and (2) of the IRPF); Imputed income (Article 6 (2) (e) of the IRPF); Capital income not include in the saving base (Article 25 (4) of the IRPF).

The table of progressive rates applies to the revenue in this base. The tax is divided into two components, State and Autonomic, which correspond to two tables of rates that may vary between Autonomy (Art. 63 (1) (1) and (2) of the IRPF).

8.4. Inclusion and Compensation in the General Base (Article 48 of the IRPF)

Net income from employment, real estate, movable capital, business and imputed income in this base is calculated by deducting specific allowances. These revenues offset each other without limitations, obtaining a positive or negative net income.

The gains or losses considered on this basis offset each other exclusively to obtain a negative or positive net income. If the balance is positive, this may be added to the positive balance of other base income. If negative in the tax period, only 25% of this balance can be offset by the positive balance calculated on the remaining net income of this base. The remaining or entire negative balance can be offset in the next four years in the following order: In the positive balance of capital gains obtained on this basis; Integration of 25% of this balance into the other positive earnings in the period.
8.5. **Inclusion and Compensation in the Saving Base (Article 49 of the IRPF)**

Revenue from movable assets and capital gains in this base only offset each other, resulting in a negative or positive balance in the tax period. When the balance is negative, it cannot be offset over the positive balance of the other revenues in the base. The compensation can only take place on the positive balance of each type of income in the following four years.

8.6. **Tax Allowances**

Prior to the calculation of tax liability and compensation after losses in each of the bases, the following allowances are deducted from the income in the general base (Article 50 of the IRPF):

1. Allowance for joint taxation (Article 84 (2) (3) and (4) of IRPF)
2. Social security payments and contributions (Articles 51 and 52 of the IRPF and 49 to 51 of the regulations), on behalf of people with disabilities (Article 53 of the IRPF and 51 of the regulations) and for disabled people’s protected assets (Article 54 of the IRPF and 71 of the regulations)
3. Alimony and child support (Article 55 of the IRPF)
4. Party fees and payments to political parties (Article 61 Bis, IRPF)
5. Allowances for professional and high performance athletes (10th additional IRPF regulation).

Taxable income in the general base is obtained from these allowances. Excess over payments or contributions under paragraphs 2 and 5 above may be carried forward over five or four years. Excess tax allowances can be deducted from the saving base up to its positive balance thus obtaining the taxable income in the saving base.

8.7. **Personal and Family Allowances**

The consideration of deductions that consider the taxpayer’s personal and family circumstances is based on the subsistence income. It quantifies the portion of the taxpayer’s income needed to satisfy his and his family’s basic needs therefore should not be taxed (Article 56 of the IRPF). To ensure the same reduction in the tax burden for all taxpayers with equal households regardless of their income level, the minimum subsistence income applies to the general base being taxed at a zero rate. Personal and family allowances are the result of adding the following amounts:

- Fixed deduction for each taxpayer/household according to age (Articles 57 and 61 of the IRPF); for each dependent (Articles 58 and 61 of the IRPF); for each ascendant (Article 59 and 61 of the IRPF); for disability of the taxpayer or his parents or children (Articles 60 and 61 of the IRPF).

The tax credits and tax benefits mentioned in Articles 69 and 70 of the IRPF and Articles 54 to 69 of regulations are deductible from tax payable in each base, obtained by applying the table of progressive rates to net payable income in the general base and the two flat rates to net payable income in the saving base.
9. Comparison Between the Portuguese IRS and Spanish IRPF

Since its introduction in 1989, the Portuguese IRS has undergone several restructurings under legislative changes made by the successive governments, based studies conducted by committees or working groups that proposed measures to improve the tax regime. The changes made to personal income tax over these twenty-three years have brought it closer to a semi-dual tax system. Table 2 compares the current structure of the IRS with the semi-dual structure of the IRPF.

Table 2
Comparison between the IRS (Portugal) and IRPF (Spain)

<table>
<thead>
<tr>
<th>IRS - Portugal</th>
<th>IRPF - Spain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue subject to general tax table – progressive by income levels</td>
<td>General Base</td>
</tr>
<tr>
<td>Mandatory aggregation</td>
<td>Revenue subject to general tax table - progressive by income levels</td>
</tr>
<tr>
<td>Income from employees (cat. A)</td>
<td>Income from employees</td>
</tr>
<tr>
<td>Income from business and professional activities (cat. B)</td>
<td>Income from business and professional activities</td>
</tr>
<tr>
<td>Income from pensions (cat. H)</td>
<td>Income from pensions</td>
</tr>
<tr>
<td>Income from real state (cat. F)</td>
<td>Income from real state</td>
</tr>
<tr>
<td>Imputed income:</td>
<td>Imputed income:</td>
</tr>
<tr>
<td>Undivided estates</td>
<td>From Real Estate</td>
</tr>
<tr>
<td>Profits of companies subject to the tax transparency regime:</td>
<td>Profits of companies subject to the tax transparency regime</td>
</tr>
<tr>
<td>Non-commercial firms</td>
<td>Profits from groupings of Spanish and EU economic interests and joint ventures</td>
</tr>
<tr>
<td>Partnerships</td>
<td>Grant of image rights</td>
</tr>
<tr>
<td>Simple asset management companies</td>
<td>Profits from non-resident companies established in tax havens</td>
</tr>
<tr>
<td>Complementary groupings of companies (ECE)</td>
<td></td>
</tr>
<tr>
<td>European Groupings of Economic Interest (AEIE)</td>
<td></td>
</tr>
<tr>
<td>Profits of non-resident companies subject to a preferential tax regime</td>
<td></td>
</tr>
<tr>
<td>Capital income (cat. E)</td>
<td>Capital income</td>
</tr>
<tr>
<td>when not received by the original author:</td>
<td>when not received by the original author:</td>
</tr>
<tr>
<td>From intellectual or industrial property</td>
<td>From intellectual or industrial property</td>
</tr>
<tr>
<td>Technical assistance fees</td>
<td>Technical assistance fees</td>
</tr>
<tr>
<td>Provision of commercial, industrial and scientific information</td>
<td>Rental of real estate, business or mines and subleases</td>
</tr>
<tr>
<td>When not considered real estate income:</td>
<td>Grant of image rights</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>IRS</th>
<th>IRPF</th>
</tr>
</thead>
</table>
| Earnings taxed at flat rates - optional aggregation with other sources of income:  
  Article 71 - Definitive taxes and Article 72 - Special CIRS rates | Saving base  
  Tax rates:  
  up to €6,000 - 19%  
  over €6,001 - 21% |
| Capital income (cat. E)  
  In general all from the investment of capital | Capital income:  
  - From investment of capital in any company  
  - Transfer to third parties of equity capital  
  - Capitalization operations  
  - Life and disability insurances premiums  
  - Revenue from any investment of capital |
| Net worth increases (cat. G)  
  Of shares and securities, derivatives, autonomous warrants and other securities | Capital losses and gains (all from transfer of equity elements) |

**Source:** Table synthesis prepared by the authors.

The data in the above table show that the IRS, as regards division between incomes subject to the table of progressive tax rates and incomes excluded from it is close to the semi-dual model in Spain, since most of the revenue included in categories E and G is excluded from aggregation with...
other sources of income. In both models the calculation of net income in each category of income takes account of specific deductions. The two models differ in the following ways:

- In the IRS, the income from capital gains on real estate is aggregated with the other sources of income, and subject to the table of progressive rates. In the IRPF this type of revenue is considered in the saving base and taxed at flat rates of 19% or 21%.
- In the IRS, capital income and capital gains are taxed at different tax rates when aggregation is mandatory or when the taxpayer exercises the option to aggregate them with the other sources of income. The definitive or the special tax applicable to this revenue varies between 20% and 35%. Some income is exempt from taxation, such as income from investment units in funds of funds.
- In the IRS, the rule is incommunicability of losses between different categories of income. It only allows reporting within the same category. The IRPF regime is more favourable because there are only limits on the communicability of losses to capital income integrated in the general or saving base according to the rules set out in Section 5 (c).
- In the IRS, there are no tax deductions on taxable income and all personal expenses are converted into deductions on the tax payable. In the IRPF there are still some deductions from net taxable income in the general base, in particular alimony, which is tax deductible in the IRS. All other personal expenses are deductible from tax payable.
- In the IRS, subsistence level applies to income coming predominantly from dependent work. In the IRPF it applies to all taxpayers, regardless of their source of income being taxed at a zero rate.
- In the IRPF, the taxation unit is the single individual. Married taxpayers may opt for joint taxation. In the IRS, married taxpayers who are not legally separated are not allowed to separate taxation. They are therefore discriminated from unmarried couples, who can choose the tax regime they feel is more favourable.
- The general base of the IRPF includes imputed income from the use of real estate by owners; in the IRS this revenue is exempted from taxation.

10. Conclusions

The task of instituting comprehensive personal income tax aimed at subjecting all income to a single table of progressive rates was not fully achieved in the 1989 Portuguese tax reform. This was due to restrictions on the communicability of losses generated in the different categories of income and the taxation applied to certain types of income that are subtracted from aggregation with other categories of income being taxed at lower flat rates or granted exemptions.

They are, essentially, revenue from financial investments included in income categories E and G. This separation is justified by administrative difficulties in monitoring taxpayers, tax competition, attracting investment and encouraging savings. (Owens, 2008) For all these reasons, the IRS is semi-dualized, although its references were based on the comprehensive model.

The Portuguese Constitution does not prevent the IRS from using the dual model. It does not prevent the establishment of two taxable bases similar to Spanish personal income tax as long as aggregation with the other sources of income remains optional.

There is now a strong awareness that income from financial investments (capital revenue and capital gains) plays an important role in the global economy. This kind of capital asset is scarce and should therefore receive particular attention from states. It does not mean that they have to be tax exempt.
It rather means that, taking account of economic globalization, the great mobility of capital, the need to attract investment and tax competition between states, this type of income has to be taxed differently from income from other sources, such as labour, wages, pensions or others.

Taxing according to source of income causes inequality and deviations from the principle of ability to pay. Although the Portuguese Constitution does not make explicit reference to this principle, it emerges from the general principle of equality set out in Article 13 of the CRP in conjunction with constitutional principles on taxes and fundamental rights. This principle is considered the appropriate criterion for fair distribution of taxation between individuals because it takes account of each person’s economic capacity. It aims to tax equally those who are equal, leaving the taxpayer an income that allows him to meet his household’s needs.

To mitigate this gap, the IRS introduced a system of optional aggregation of income in category E and G, mainly for some earnings taxed at the rates set out in Articles 71 and 72 of the CIRS. Although this regime is optional, it can be regarded as the element that supports realization of the constitutional aim of a single, progressive tax, though it depends on the taxpayer’s wishes. These reasons that lead us to admit the possible evolution of the Portuguese tax to a semi-dual model.

The way to go will be to optimize the IRS in order to harmonize the rates provided for in Articles 71 and 72 of the CIRS and to eliminate the existing exemptions. A true regime of communicability of losses should be established. This could be similar to that in the Spanish IRPF, although there are some restrictions. Total communicability of losses between labour income, pensions, business and professional income and real estate should be allowed in the general base.

Income category H (pensions) should be included in income category A. Joint taxation should be optional for married taxpayers, equal to unmarried taxpayers living in a registered partnership.

The rules on non-resident taxpayers should be included in separate law, like in the IRPF, thereby contributing to further clarification of the rules of the CIRS.

Some OECD countries have been replacing comprehensive models with semi-dual models. In the former models there is differentiation between taxation of labour income, usually taxed at higher progressive rates, and capital income, taxed at lower flat rates. In dual models, the tax rate on capital income is normally aligned with the corporate tax rate and both are equal to the tax rate on the lowest bracket of labour income, thereby reducing arbitrage by taxpayers in transforming labour income into capital income.

The Spanish personal income system implemented in 2007 followed this international trend and established two bases: the saving base that includes all income from securities and real estate investments, taxed at two flat rates, and the general base that covers all other income. The semi dual Spanish deals better with international tax competition because, on establishing two separate tax bases, allows the mobile base (capital gains income) to be taxed by proportional rates, lower than the progressive rates that are subjected the labour and pensions income. Semi-dual systems meet better the challenges of capital mobility, the needs of foreign investment and the rise of tax competition between states due to economic globalization.

11. References


**Annex**

Components of the two bases of the IRPF
Income from financial investments (Article 25 (1), (2) and (3) of the IRPF) from:
- From intellectual or industrial property
- Technical assistance fees
- Hiring out of movable assets, businesses or mines and subleases
- Grant of image rights
- From business and professional activities

Revenue

Imputed income
- From real estate
- International tax transparency
- Grant of image rights
- From financial institutions established in tax havens
- From joint-ventures and groupings of Spanish and EU economic interests

Capital gains and losses
Capital gains and losses not resulting from the transfer of assets

Table of progressive rates

Saving base

Revenue
- Income from financial investments (Article 25 (1), (2) and (3) of the IRPF) from:
  - Shareholdings
  - Transfer of equity to third parties
  - Capitalization operations
  - Life and disability insurance premiums
  - Other income from investment of capital

Capital gains and losses
Capital gains and losses resulting from the transfer of assets

Flat rates:
€ 6,000 - 19%
€ 6,001 - 21%

Source: Adapted from Ministerio de Economía y Hacienda (2010:367)\(^6\)

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