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6
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Corporate tax evasion and government persuasion: a comment on a fiscal measure

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resumo

O objectivo deste texto é o de analisar a situação fiscal das empresas portuguesas relativamente ao imposto sobre o rendimento (IRC). Argumenta-se que a percepção de uma elevada fuga fiscal nas pequenas empresas levou o governo a introduzir, em 1998, um mecanismo de persuasão para tentar aumentar as receitas. As estatísticas do IRC relativas a 1998 mostram que a medida não teve o efeito desejado, o que explica o recurso a uma nova política de tributação das pequenas empresas consagrada no Orçamento de Estado para 2001.

résumé / abstract

Ce texte se propose d'analyser la situation fiscale des entreprises portugaises en ce qui concerne l'impôt sur le revenu (IRC). On argumente que la prise de conscience d'une évasion fiscale élevée dans les petites entreprises a contraint le gouvernement d'introduire, en 1998, un mécanisme de persuasion afin de tenter d'augmenter les recettes. Les statistiques concernant l'IRC, pour l'année 1998, montrent que les mesures prises n'ont pas eu l'effet escompté, ce qui explique le recours à une nouvelle politique d'imposition des petites entreprises, laquelle se trouve consacrée par le budget de l'Etat pour l'année 2001.

The purpose of this paper is to discuss a tax measure introduced in December of 1998 by the Portuguese tax authorities, its consequences on corporate taxpaying behaviour and a new policy introduced in the State Budget for 2001. In 1998, a kind of persuasive legislation to influence entities subject to the corporate income tax was established, as it would result in auditing if taxable profits less than their sectoral average, computed for the period 1994-1996, were reported in 1998. Looking at statistics of tax receipts of 1998, the paper debates the impact of the aforementioned tax measure in the corporate income tax and, finally, a different approach to the taxation of income of small corporations – inserted in the State Budget of 2001 – is highlighted.

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1. Introduction

The fairness of the Portuguese corporate income tax (CIT)[2] is an area of tax policy that has, in recent years, often been in the spotlight. Statistics of tax receipts show a very uneven distribution of CIT burden across taxpayers, and the media is saturated with statements from politicians, tax experts and academics, arguing about the tax evasion practised by many corporate taxpayers. The purpose of this paper is to discuss a tax measure introduced in December of 1998 by the Portuguese tax authorities and its perceived consequences on corporate taxpaying behaviour. This measure was a type of threat to entities subject to CIT, as it would result in auditing if taxable profits less than their sectoral average, computed for the period 1994-1996, were reported in 1998. This new experimental approach by tax authorities has come about given evidence of considerable tax evasion, especially in the area of small business.

Looking at statistics of tax receipts of 1998, I analyse the impact of the aforementioned tax measure in the corporate income tax and, finally, a different approach to the taxation of income of small corporations[3] – inserted in the State Budget of 2001 – is highlighted.

The paper is organised as follows: section 2. presents statistical evidence of CIT receipts, both from aggregate and micro perspectives, aiming at illustrating the need of some corrective measures to increase the number of effective taxpayers, particularly in the small firm universe; section 3. discusses the particular measure enacted by tax authorities, mainly on two grounds: how seriously should corporations take the government warning of audit intensification and what should be the expected results in terms of tax receipts; section 4 focuses on the impact of that measure in corporate tax receipts and discusses the causes for the new approach to the taxation of small firms inserted in the Budget for 2001; section 5 concludes.

2. Recent trends in corporate income taxation in Portugal

2.1 A macro analysis

From an aggregate perspective – see table 1 – the evolution of tax proceeds from CIT related to Gross Domestic Product (GDP) from 1990 to 1998 shows a similarity between Portugal and average European Union (U.E.) values. In 1996 and 1997 a growing importance of those receipts in comparison to U.E. countries can be detected in Portugal.

Table 1 – CIT as a percentage of GDP

	CIT	
	PORTUGAL	U.E. (average)
1990	2.5	2.7
1991	3.0	2.6
1992	2.7	2.4
1993	2.3	2.6
1994	2.4	2.7

2 In this paper I will use corporate income tax (CIT) as the English equivalent of "imposto sobre o rendimento das pessoas colectivas – IRC", although IRC applies not only to corporations but also to other types of economic entities, like limited liability companies. Throughout the paper the term "corporations" will also be used meaning all the taxpayers registered in CIT files.

3 Although there are different definitions of small corporations, we will refer to firms with a turnover less than 100 MPTE.

(contin.)	CIT	
	PORTUGAL	U.E. (average)
1995	2.8	2.9
1996	3.3	3.1
1997	3.8	3.1
1998	3.7	b)

b) Not available
Sources: Meireles (1998); Banco de Portugal (1998)

If we analyse the contribution of CIT to the structure of global tax receipts in Portugal between 1995 and 1997 – see table 2 – a good momentum of corporate taxation inflows is clear. During the period, CIT receipts are the most dynamic component of global tax receipts. The weight of direct taxation grew from 38.96% to 42.55% of global receipts, a trend which was almost exclusively related to CIT.

Table 2 – Structure of global tax receipts in Portugal

						(10^9 PTE)
	1995	1996	1997	%		
				1995	1996	1997
CIT	390.1	488.2	590.8	11.48%	13.37%	14.69%
PIT *	919.8	1 022.6	1 107.3	27.08%	28.01%	27.53%
Other direct taxes	13.7	13.4	13.2	0.40%	0.37%	0.33%
Total of direct taxes	1 323.6	1 524.2	1 711.3	38.96%	41.74%	42.55%
VAT **	1 124.9	1 131.1	1 267.0	33.12%	30.98%	31.50%
Excise tax (oil)	427.9	448.3	481.1	12.60%	12.28%	11.96%
Excise tax (autos)	132.6	154.8	168.9	3.90%	4.24%	4.20%
Excise tax (tobacco)	151.0	161.0	174.1	4.45%	4.41%	4.33%
Stamp duties	191.9	188.8	178.3	5.65%	5.17%	4.43%
Other indirect taxes	45.0	43.2	41.1	1.32%	1.18%	1.02%
Total of indirect taxes	2 073.3	2 127.2	2 310.5	61.04%	58.26%	57.45%
TOTAL TAX RECEIPTS	3 396.9	3651.4	4 021.8	100.00%	100.00%	100.00%

Source: Meireles (1998)
*- personnal income tax ** - value added tax

A macro analysis of CIT in Portugal reveals signs of a stable tax in terms of proceeds and, apparently, should not be one of the most pressing concerns of tax authorities. However, the fact is that corporate taxation is a highly debated issue in Portuguese tax policy and legislative measures to tackle some of the problems in this area of taxation policy have been relatively frequent[4]. A different – micro – analysis of the CIT will identify its contentious aspects and clarify the need for the recently implemented policy measures.

4 We can point out the special advanced payment (1998) and to the (failed) introduction of the minimum tax.

2.2 A microanalysis of CIT

The microanalysis of CIT requires a previous characterisation of the universe of Portuguese corporate taxpayers. Table 3 contains some useful data.

Table 3 – Number of corporate taxpayers by turnover

(10^3 PTE)

TURNOVER CLASSES		1995	%	1996	%	1997	%	% change 95/96	% change 96/97
1	0	38 588	18	46 346	20	44 332	19	20	-4
2	0 to 30 000	100 298	48	109 646	47	106 825	46	9	-3
3	30 000 to 100 000	37 877	18	41 719	18	42 891	18	10	3
4	100 000 to 200 000	13 808	7	15 053	6	15 886	7	9	6
5	200 000 to 300 000	5 767	3	6 204	3	6 695	3	8	8
6	300 000 to 500 000	5 041	2	5 576	2	5 818	3	11	4
7	500 000 to 1 000 000	4 030	2	4 396	2	4 796	2	9	9
8	1 000 000 to 2 500 000	2 577	1	2 788	1	2 948	1	8	6
9	2 500 000 to 5 000 000	698	0	801	0	903	0	15	13
10	5 000 000 to 15 000 000	479	0	520	0	541	0	9	4
11	15 000 000 to 50 000 000	131	0	160	0	167	0	22	4
12	more than 50 000 000	56	0	64	0	73	0	14	14
	TOTAL	209 350	100	233 273	100	231 875	100	11	-1

Source: Meireles (1998)

In general, in terms of turnover, the Portuguese corporate world is a small and microentreprise domain. From 1995 to 1997 firms with a turnover of less than 100 Million PTE (0.5 M Euro) represent about 85% of total taxpayers registered in tax services. (The number of registered corporations without any activity and no turnover is also constant, around 20%). On the other hand, corporations with a turnover greater than 2 500 M PTE (12.5 M Euro) are less than 1% of the total.

Given this corporate structure, a natural question arises: is the observed growth in CIT inflows a general trend that affects all corporate quarters, or is it the result of a concentration of tax receipts in a particular segment of taxpaying corporations?

Before turning to this analysis, let us appreciate – see table 4 – how accounting profits / losses are reflected in CIT due[5].

From table 4 a pattern emerges,where the evolution of the proportion of taxpayers with positive accounting profits is clearly contrasted with the evolution of assessed tax. In fact, corporations with accounting profits greater than zero are more than 50% of the total, and there is a growing trend from 52% in 1995 to 56% in 1997. This is even more evident in the taxable profit evolution. But this trend is hardly reflected in the number of corporations that effectively paid the CIT. From 1995 to 1997 the number of corporations that do not pay any CIT only diminishes from 61% to 58%.

5 According to CIT Code taxable profits are based on accounting values, albeit corrected in terms of CIT regulations.

Table 4 – Number of tax files (Registered tax payers wish economic activity)

	1995	%	1996	%	1997	%	% change	
							95/96	96/97
Turnover > 0	170 762	89	186 927	89	187 543	89	9	0
Turnover = 0	20 323	11	24 206	11	24211	11	19	0
Accounting profits > 0	98 843	52	110 952	53	118 034	56	12	6
Accounting profits = 0	444	0	467	0	420	0	5	-10
Accounting profits < 0	91 798	48	99 714	47	93 300	44	9	-6
Taxable profit > 0	105 496	55	119 028	56	125 605	59	13	6
Taxable profit = 0	695	0	337	0	809	0	-52	140
Taxable profit < 0	84 894	44	91 768	43	85 340	40	8	-7
Collectible profit* > 0	76 529	40	85 598	41	91 222	43	12	7
Collectible profit = 0	114 556	60	125 535	59	120 532	57	10	-4
Assessed ** CIT > 0	74 268	39	83 242	39	88 830	42	12	7
Assessed CIT = 0	116 817	61	127 891	61	122 924	58	9	-4

Source: Meireles (1998)
* - Collectible profit (matéria colectável) is equal to taxable profit (lucro tributável) minus losses carried over and some tax benefits
** - I use "assessed tax" as the english equivalent of IRC liquidado

As taxable profits show a similar trend to accounting profits, the explanation for the divergence between accounting profits and assessed tax is to be found in the evolution of collectible profit, where the effects of tax losses carried forward are shown on global corporate taxable income. Deduction of accumulated losses is therefore the main cause of the notorious difference between collectible and accounting profits.

Table 5 – The evolution of tax losses and tax profits

(10^9 PTE)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	TOTAL
Tax losses	622	629	792	1 059	1 227	955	910	941	817	7 951
Tax profits	806	880	994	934	1 003	1 200	1 432	1 902	2 645	11 795

Source: Meireles (1998)

From table 5 we can observe a pattern of the evolution of tax losses that – as expected – is related to the economic cycle.

From 1992 to 1994 Portuguese GDP growth entered a negative cycle, corporate profits being naturally affected by the overall economic performance. In 1992 and 1993 global tax losses are greater than tax profits. The concentration of tax losses should therefore have a marked effect on tax receipts from 1995 onwards, given the loss deductibility of past losses for six years.

Table 6 confirms this.

Deductible tax losses show a notoriously increasing trend from 1995 onwards. Clearly, tax receipts must have been affected, as table 4 has already shown.

Table 6 – Deducted tax losses

(10⁹ PTE)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	TOTAL
N.of taxpayers deducting losses	14 851	18 891	21 686	22 294	27 617	34 827	40 166	45 478	46 931	272 741
Amount	108	100	161	131	198	242	275	351	448	2 014

Source: Meireles (1998)

Tax losses appear to be one of the main culprits – perhaps even "the" culprit – of the divergence between accounting profits and tax receipts from corporate income. We will now turn to a more detailed analysis of the distribution of the losses. Table 7 presents some interesting evidence.

Table 7 – Total losses

(10^9 PTE)

	TURNOVER CLASSES *(10^3 PTE)*	1995				1996				1997			
		N. of tax files	%	Losses	%	N. of tax files	%	Losses	%	N. of tax files	%	Losses	%
1	0	16 640	20	105	12	20 048	22	150	16	19 763	23	124	16
2	0 to 30 000	51 115	60	135	15	54 176	59	144	16	49 939	59	127	16
3	30 000 to 100 000	10 430	12	89	10	10 794	12	92	9	9 707	11	74	9
4	100 000 to 200 000	2 948	3	60	7	3 039	3	58	6	2 715	3	46	6
5	200 000 to 300 000	1 139	1	30	3	1 114	1	41	4	982	1	30	4
6	300 000 to 500 000	988	1	42	5	1 014	1	40	4	871	1	34	4
7	500 000 to 1 000 000	792	1	73	8	778	1	74	7	673	1	48	7
8	1 000 000 to 2 500 000	573	1	91	10	530	1	86	9	455	1	78	9
9	2 500 000 to 5 000 000	142	0	43	5	135	0	74	8	124	0	49	8
10	5 000 000 to 15 000 000	94	0	51	6	99	0	64	7	79	0	52	7
11	15 000 000 to 50 000 000	22	0	87	10	27	0	55	6	20	0	100	6
12	more than 50 000 000	11	0	104	11	14	0	65	8	12	0	56	8
	TOTAL	84 894	100	910	100	91 768	100	941	100	85 340	100	817	100

Source: Meireles (1998)

From 1995 to 1997 more than 90% of tax files that present tax losses are submitted by taxpayers with a turnover of less than 100 M PTE. Obviously, in terms of total losses, they represent about 40% of them, but one can not be unimpressed by the proportion of taxpayers who are not paying any corporate tax. The result of this concentration of losses is quite clear from table 8, where a comparison can be made between the proportion of taxes paid and the number of tax forms, when corporations are grouped into classes of assessed tax.

Looking at table 8 we can not but suspect that a large number of – particularly small – corporations did not pay their "fair share" of CIT. In fact, more than 60% of registered taxpayers did not pay any CIT during these three years. And there is a dangerous concentration of tax receipts in the two largest groups.

Table 8 – Assessed CIT

(10^9 PTE)

CLASSES OF CIT DUE *(10^3 PTE)*	1995				1996				1997			
	N. of tax files	%	CIT	%	N. of tax files	%	CIT	%	N. of tax files	%	CIT	%
= 0	131 881	63	1	0	149 601	64	1	0	141 758	61	1	0
0 to 1 000	57 760	28	14	4	61 782	26	17	4	65 772	28	17	4
1 000 to 3 500	12 434	6	22	6	13 607	6	25	6	15 101	7	27	6
3 500 to 10 000	4 489	2	24	7	5 142	2	29	7	5 654	2	31	7
10 000 to 50 000	2 159	1	41	11	2 423	1	48	11	2 740	1	53	12
50 000 to 250 000	496	0	50	14	551	0	55	13	655	0	65	15
250 000 to 5 000 000	126	0	95	26	162	0	114	27	190	0	141	33
> 5 000 000	5	0	116	32	5	0	138	32	5	0	144	34
TOTAL	209 350	100	363	100	233 273	100	428	100	231 875	100	479	100

Source: Meireles (1998)

Table 9 also sheds some light on this topic. In this table I compare the evolution of the total of CIT receipts with the contribution of corporations that paid more than 10 M PTE. As can be seen in the last column of the table, from 1996 to 1997 just 3617 taxpayers (1.55%) are responsible for the entire increase in CIT total inflows.

To sum up, if from an aggregate perspective CIT appears to be a highly dynamic tax in terms of its contribution to total tax receipts, the analysis of the tax burden distribution across turnover classes evidences a worrying pattern of tax bill concentration which clearly reduces the fairness of this tax.

Table 9 – Contribution of biggest taxpayers to total increase in tax recepts

(10^9 PTE)

	Corporations paying more than 10 M PTE (A)			All taxpayers (B)			% (A) (B)	
	1995	1996	1997	1995	1996	1997	1995/96	1996/97
	Number of files							
	2 821	3 167	3 617	209350	233273	231875		
	CIT computation							
1. Tax due	324	371	423	378	443	495	71%	100%(*)
2. Deductions – of which: tax benefits	8	9	8	10	10	9	184%	88%
3. Assessed Tax	310	357	408	363	428	479	72%	100%

Source: Meireles (1998)

* - The number of taxpayers with more than 10 M PTE of tax due were responsible for an increase of 52×10^9 PTE (423-371). Given that the total increase in tax due from 1996 to 1997 was 52×10^9 PTE (495-443), then 1.55% of total corporations originated the total increase in CIT due.

To counter this trend, the Portuguese government has implemented several measures aimed at correcting this situation. One of them was the publication of a law, at the end of 1998, containing what can be called a persuasive mechanism. We will now turn to the analysis of this policy.

3. Tax evasion and government persuasion

According to the statement of tax authorities published on the 23rd December of 1998:

"In 1999, tax services will develop a vast operation aimed at corporate taxpayers. Audited corporations will be selected, namely, by criteria based on significant differences between their "tax profitability" and the statistical averages of tax profitability of their corporate sector during the period 1994 -1996...

The calculation of tax profitability (TP) will be made according to the following algorithm:

$$TP = \frac{\text{Taxable profit (loss)}}{\text{Turnover}} \times 100 \text{ "}$$

The tax authorities annexed a list showing tax profitability values of each economic sector to this statement. These were grouped by the standard classification of economic activities (CAE).

This policy may be appreciated in two areas:

a) How seriously should this form of warning be taken by corporations given the resources of the tax auditing services?

b) What would its likely impact be on corporate tax receipts?

As far as the former is concerned, we can only say that it is surely one of the most important factors linked to the effectiveness of this kind of tax warning. The role of tax auditing services within the organisational structure of the tax authorities is acknowledged as a decisive element of a tax system. Basto (1994) states that the visibility of the tax auditing services is one of the crucial aspects in the compliance of taxpayers, even if the auditing activities do not produce any additional receipt. The same author argues for an adequate level of staff within the tax auditing services and is against a policy of "budget starvation", in that it incurs higher costs in terms of auditing activities.

The situation illustrated in section 2. is, we suspect, clearly related to the intuition – or even the certainty – of most corporate taxpayers that the probability of being audited is very low, culminating in a snowball effect: as time passes more and more corporate taxpayers are tempted to "cook the books" for tax purposes[6].

The report of the Commission for the Development of Tax Reform – published in 1996[7] – was not very optimistic about the organisational structure of tax services. In particular, technical staff committed to auditing activities is clearly not sufficient in order to make pursuing a policy of adequate corporate auditing viable.

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6 The General Law of Taxation (*Lei Geral Tributária*) – chapter V, section II – establishes the possibility of utilisation of indirect methods of determination of collectible income by the CIT auditing services. However, the statement of tax authorities analysed in this paper is not, per se, an application of this rule. The lower than average tax profitability of a firm can lead to its auditing; and only in this auditing process can, eventually, the indirect methods of determination of collectible income be applied if the firm´s tax situation is in conformity with article 87 of the mentioned Law.Even then, the taxpayer can ask for the revision of the estimated income – article 91.

7 See Comissão para o Desenvolvimento da Reforma Fiscal (1996)

This report states that the quantity of employees committed to auditing activities is low (24% of total staff) and a large number of them do not possess appropriate qualifications. CIT auditing is still strongly oriented to in-house checking activities – like analysing tax forms –, which results in a low visibility of tax experts to the corporate world.

Even assuming that the threat of being audited should have induced an increase in the 1998 corporate tax payments from micro and small enterprises, if a significant proportion of corporations declaring losses are not audited then it is not difficult to forecast a regression to the prevailing situation.

From the second point, I now examine the likely impact of this kind of governmental persuasion on tax receipts. Let me begin by stating that given the corporate universe under surveillance – particularly micro and small corporations – even if excellent results were achieved in terms of increase in taxable profits, an extraordinary effect on the total of corporate income tax receipts will not be produced.

Let us take another look at table 8 and assume that in 1997 the tax payments of the 89% of corporations with less than 1 M PTE of tax due would increase by 50%. The tax paid by these corporations would then be 27 000 M PTE (instead of 18 000 M PTE). If, in the same year, the 195 corporations with tax due higher then 250 000 M PTE reduced their tax bills by 3.1% than the total of receipts will not change. Given the uneven distribution of tax receipts, the warning from tax authorities would have more impact on the perceived fairness of corporate taxation and less on the increase in tax receipts. However, one must not forget that, in terms of tax receipts, an increase in taxable profits would have a double effect: higher tax receipts in 1998 and also a diminishing of tax losses to be carried forward.

Another interesting point in this persuasive approach of the tax authorities to corporate taxpayers was related to the fact that the sector averages mentioned in the Statement of the 23rd of December were based on 1994-1996 corporate tax files. For some sectors tax profitability indexes were quite low[8]. I suspect that the rise in the inclination towards tax compliance, which some accountants spoke of suddenly finding in some owners / managers of micro and small Portuguese corporations at the closing of tax season of 1998, could largely be due to perceived "advantageous" profitability indexes. The extra tax to be paid when taxed by the average profitability index would be less than the cost of being audited.

To conclude this section, I would like to stress that this policy towards corporate taxpayers may be a significant step in the fight against tax evasion. Even if, as expected, it would not produce significant increases in tax receipts, it could contribute to the real and perceived fairness of the tax system. To succeed, the tax authorities should increase auditing activities in order to show real willingness to verify corporate accounting data.

As an academic and as a taxpayer I waited eagerly for the corporate income tax data of 1998. The analysis of those data is the next step of this paper.

4. Some results and new measures

4.1 An agregate analysis of 1998 CIT data

Given that the warning of tax authorities – in terms of increasing the auditing probability – was based on the taxable profits declared by firms in 1998, table 10 shows the evolution of taxable profits from 1996 to 1998.

The conclusion that can be drawn is that the tax authorities warning was not taken very strongly by corporations it was deliberately aimed at. In fact, the comparison with 1997 shows that

8 For example – metalworks: 0.88, selling autos: 0.29, beer bars: 0.38, restaurants:1.03, job training: 0.42.

Table 10 – Taxable profit by turnover classes

TURNOVER CLASSES (10^3 PTE)		1996	%	1997	%	1998	%	% change 97/96	% change 98/97
									(10^9 PTE)
1	0	171	9	225	8	178	7	31	-21
2	0 to 30 000	71	4	135	5	84	3	92	-38
3	30 000 to 100 000	119	6	383	14	112	4	220	-71
4	100 000 to 200 000	71	4	86	3	116	5	21	35
5	200 000 to 300 000	50	3	69	3	66	3	38	-5
6	300 000 to 500 000	63	3	77	3	88	3	22	15
7	500 000 to 1 000 000	93	5	112	4	131	5	20	18
8	1 000 000 to 2 500 000	151	8	183	7	184	7	21	1
9	2 500 000 to 5 000 000	199	5	140	5	171	7	39	22
10	5 000 000 to 15 000 000	188	10	194	7	258	10	3	33
11	15 000 000 to 50 000 000	201	11	267	10	249	10	33	-7
12	more than 50 000 000	623	33	858	31	882	35	38	3
	TOTAL	1902	100	2728	100	2520	100	43	-8

Source: Direcção de Serviços de IRC (2000)

Table 11 – Assessed CIT by turnover classes

TURNOVER CLASSES (10^3 PTE)		1996	%	1997	%	1998	%	% change 97/96	% change 98/97
									(10^9 PTE)
1	0	4	1	2	0	10	2	-36	333
2	0 to 30 000	10	2	11	2	11	2	5	5
3	30 000 to 100 000	18	4	20	4	20	4	10	3
4	100 000 to 200 000	16	4	18	4	20	4	13	11
5	200 000 to 300 000	12	3	14	3	16	3	12	13
6	300 000 to 500 000	16	4	18	4	22	4	15	19
7	500 000 to 1 000 000	23	5	26	5	32	6	10	25
8	1 000 000 to 2 500 000	36	8	42	9	48	8	19	12
9	2 500 000 to 5 000 000	27	6	35	7	45	8	30	28
10	5 000 000 to 15 000 000	49	12	48	10	50	9	-3	5
11	15 000 000 to 50 000 000	37	9	54	11	60	11	47	11
12	more than 50 000 000	179	42	200	41	234	41	12	17
	TOTAL	428	100	488	100	569	100	14	16

Source: Direcção de Serviços de IRC (2000) corporations with turnover up to 100 MPTE decrease their taxable profits, even in absolute terms, in 1998. Firms with turnover between 30 MPTE and 100 MPTE declared even less than in 1996! And as the economic expansion went on in 1998, macroeconomic factors can not be blamed for that decline in taxable profits.

A possible – albeit somewhat speculative – cause, can be even atributed to the warning itself: if profitable corporations did just align their taxable profits for the average sectoral values published by tax authorities and loss driven firms did not increase their share of taxable profits, then, on the agregate level, things turned worse.

Table 11, that shows the evolution of asessed CIT, presents an identical picture.

Given tax data for 1998, one can safely conclude that the corporate tax policy described in section 3 – based on taxpayer´s persuasion – did not produce its intended results. The share of corporate tax paid by very small firms did not increase, and the concentration of corporate tax recepts was, again in 1998, a feature of the portuguese tax system.

4.2 A new approach to the taxation of income of small firms

The State Budget for 2001 – Law 30-C/2000, 29th December – introduced a new way to deal with the taxation of profits of small firms. In brief, the new approach, called "Simplified Taxation", applies to firms with a turnover of less than 30 M PTE. If they choose this new system[9], they face a corporate tax of 20%, which will be applied to a taxable income (TI) based on sectoral profitability ratios[10]. During a transition period, while these sectoral ratios are not available, taxable income will be computed according to the following alghoritm:

i) TI = 0.25 S + 0.45 OR;

ii) TI>AMS

Where S – sales; OR – other revenues, AMS – annual minimum salary.

The new approach has the main consequence ot taking the impact of past loss deduction out of the tax bill. With the kind of statutory minimum taxable income defined in ii) small firms will have to pay some CIT. This will be, for the managers of most of them, a new sensation.

5. Conclusion

A macro analysis of CIT in Portugal reveals signs of a stable tax and, apparently, should not be one of the most pressing concerns of tax authorities. However a micro analysis of the CIT reveals some contentious aspects, namely the fact that a large number of – particularly small – corporations do not pay their "fair share" of CIT.

To counter this trend the Portuguese government has recently implemented several measures aimed at correcting this situation. One of them was the publication, at the end of 1998, of a persuasive mechanism. We analysed this policy on two grounds: how seriously could this form of warning be taken by corporations given the resources of the tax auditing services, and what would its likely impact be on corporate tax receipts?

CIT auditing is still strongly oriented to in-house checking activities – like analysing tax forms –, which results in a low visibility of tax experts to the corporate world. The tax services are also understaffed to carry out a large auditing intensification of corporations.

9 Firms still have the choice of being taxed by the normal rules of CIT.
10 It is supposed these ratios will be computed from a Tax Services database.

According to tax data for 1998, the warning from tax authorities did not have any impact on the perceived fairness of corporate taxation.

This is surely one of the main causes of the introduction, in 2001, of a new approach – the Simplifired Taxation – to deal with this problem, with the introduction of a kind of minimum tax not affected by past losses.

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