
THE TAX DISPUTES AND LITIGATION REVIEW

SECOND EDITION

EDITOR
SIMON WHITEHEAD

LAW BUSINESS RESEARCH

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This article was first published in The Tax Disputes and Litigation Review, 2nd edition
(published in February 2014 – editor Simon Whitehead).

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THE TAX DISPUTES AND LITIGATION REVIEW

Second Edition

Editor
SIMON WHITEHEAD

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
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ISBN 978-1-907606-94-6

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

BAKER & MCKENZIE LLP

BOWMAN GILFILLAN

ECONOMIC LAWS PRACTICE

FLICK GOCKE SCHAUMBURG

GIDE LOYRETTE NOUEL

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EDITOR'S PREFACE

The objective of this book is to provide tax professionals involved in disputes with revenue authorities in multiple jurisdictions with an outline of the principal issues arising in those jurisdictions. In this, the second edition, we have continued to concentrate on the key jurisdictions where disputes are likely to occur for multinational businesses.

Each chapter provides an overview of the procedural rules that govern tax appeals and highlights the pitfalls of which taxpayers need to be most aware. Aspects that are particularly relevant to multinationals, such as transfer pricing, are also considered. In particular, we have asked the authors to address an area where we have always found worrying and subtle variations in approach between courts in different jurisdictions, namely the differing ways in which double tax conventions can be interpreted and applied.

Perhaps it is merely a perception from a jurisdiction whose prime minister has publicly vilified a multinational for complying with the national tax laws, but tax avoidance seems to have become the new international evil. As such, this book provides an overview of each jurisdiction's anti-avoidance rules and any alternative mechanisms for resolving tax disputes, such as mediation, arbitration or restitution claims.

We have attempted to give readers a flavour of the tax litigation landscape in each jurisdiction. The authors have looked to the future and have summarised the policies and approaches of the revenue authorities regarding contentious matters, addressing important questions such as how long cases take and situations in which some form of settlement might be available.

We have been lucky to obtain contributions from the leading tax litigation practitioners in their jurisdictions. Many of the authors are members of the EU Tax Group, a collection of independent law firms, of which we are members, involved particularly in challenges to the compatibility of national tax laws with EU and EEA rights. We hope that you will find this book informative and useful.

Finally, I would like to acknowledge the hard work of my colleague Federico Cincotta in the editing and compilation of this book.

Simon Whitehead

Joseph Hage Aaronson LLP

London

February 2014

Chapter 18

PORTUGAL

Francisco de Sousa da Câmara and António Lobo Xavier¹

I INTRODUCTION

The Portuguese tax system is formed by a fairly complete set of legal rules applying to the relationship and interaction between taxpayers and the tax authorities in its various aspects, including tax inspections, litigation, infringements and penalties, seizures and the execution of tax debts.

Against this backdrop, the litigator's task and skill lies in defining strategy and optimising the available possibilities (essentially, associating procedural and technical rules with comprehensive knowledge of the substantive regime).

Portugal is sometimes portrayed as a jurisdiction in which litigation is a time-consuming and convoluted endeavour. Nevertheless, with effective navigation many pitfalls can be avoided and advantageous routes identified. Such navigation involves knowledge and mastery of proof in all its forms (documentation, witnesses, expert opinion, jurisprudence and doctrine at the national, international, EU and double taxation treaty (DTT) level), but also a determination to reach a stage of completion by requiring the tax authorities to adopt specific behaviours, such as the immediate payment of a refund with interest, or, where relevant, refraining from a given action, such as pledges or mortgages that taxpayers consider should be avoided under a foreclosure process. The tax arbitration courts, created in 2011, have shown themselves to be a unique and very efficient mechanism and alternative to settle tax disputes (see below). Several public foreign delegations have been reviewing these specific rules, the new jurisprudence and the way in which these courts are evolving through visits to the premises in Lisbon, and through analysis of the courts and their administrative staff to evaluate the entire system.

¹ Francisco de Sousa da Câmara and António Lobo Xavier are partners at Morais Leitão, Galvão Teles, Soares da Silva & Associados, RL.

Among the principles with which tax rules and procedures must comply, we would stress the importance and significance of the principle of legality, whereby the most important aspects of the tax system (including the determination of what is subject to tax, tax rates, tax incentives and taxpayers' rights and guarantees) must be settled by laws approved by the parliament, or by laws made by the government under the express authorisation of the parliament. The resolution of tax disputes is included in the rights and guarantees of taxpayers, and therefore is covered by the principle of legality.

Recently, we have observed an aggressive stance on the part of the tax authorities against tax planning. At the same time, we have also witnessed a growing awareness on the part of taxpayers of their rights and the need for these to be safeguarded. This assertiveness is changing the tax litigation landscape. Taxpayers have demonstrated their willingness to demand refunds of tax considered unduly assessed, and a determination to obtain indemnity interest from the state when tax has been unduly paid, in particular using the arbitration mechanism to speed up the process. Additionally, taxpayers have begun to enforce civil, disciplinary and criminal liability against the tax authorities and its civil servants. Taxpayers have, furthermore, asked the courts to sentence the state and its public servants to pay pecuniary sanctions and penalties when irregularities have been detected.

In the context of the legal environment for the resolution of tax disputes, there are three additional aspects that should be highlighted:

- a* the resolution of tax disputes is regulated by a complex set of legal rules that determine different types of actions, deadlines, etc., depending on the type of dispute in question;
- b* the resolution of tax disputes is effected in written procedures, so the mediation principle plays a secondary role, and an informal or negotiated resolution of disputes plays no part in the architecture of the system; and
- c* there is a visible trend towards the use of digital technology in what concerns the relationship between taxpayers and the tax authorities. While in tax courts the development of the litigation process is still being processed in paper format (with online access to the file), the tax authorities are increasingly exploiting the technology, and tax disputes that are dealt with entirely within the ambit of the tax authorities may be processed and documented entirely by electronic means. Moreover, the execution process (i.e., the process initiated to obtain the compulsory payment by the taxpayer of its tax debts) is now mainly electronic, with the consequence that the human participation element in the process is progressively disappearing, and the relevant acts are produced *en masse*.

II COMMENCING DISPUTES

In general terms, tax disputes may arise for myriad reasons, although in the majority of cases a tax dispute arises because of an alleged illegality identified by the tax authorities.

The majority of tax disputes have their origin in a tax assessment. Tax assessments may be made by the tax authorities (as is the case with personal income tax and with the tax on the acquisition of immoveable property, based on information disclosed by taxpayers) or directly by taxpayers (as is generally the case with corporate income tax and VAT).

i Corrections and amendments to tax returns

Both information disclosed to the tax authorities and tax assessments made directly by taxpayers may be substituted or corrected within certain time frames in the event of errors. In the case of personal income tax, the information can be corrected during a period of four years. Regarding corporate income tax, the taxpayer may substitute its tax assessment during a period of one year in the event that it is going to assess less tax than initially assessed, or at any time if it is going to assess more tax than initially assessed. In relation to VAT, if the taxpayer has assessed less tax than the tax due, it is obliged to correct the VAT return with no time limitation. However, if the taxpayer has assessed more tax than the tax due, the correction is optional and may only be made within two years of the presentation of the original VAT return.

In the event that these deadlines have expired, the taxpayer may only attempt to correct tax assessments by initiating a formal dispute.

ii Administrative and judicial disputes related to tax assessments

Tax disputes may have both an administrative and a judicial phase.

The administrative phase is either optional or mandatory, depending on the case, and is characterised by being free of charge and involving less formal requirements than the judicial phase. The administrative phase may have two stages: the initial claim and, in the case of an express or tacit negative decision, the possibility to lodge an appeal against the decision of the initial claim to the Minister of Finance before moving to court. The tax authorities have no deadline to decide these claims and appeals, but taxpayers, to avoid waiting indefinitely for an express decision, can presume a negative decision (four months after presentation of the claim or 60 days in relation to appeals) for the purposes of moving on with the dispute to the tax courts. Depending on a number of factors, but most importantly the complexity of the matter, the time frame for an express decision by the tax authorities may vary between a few months and several years. Nevertheless, one may identify a perceivable trend towards a progressive and swifter resolution of disputes in the administrative phase.

Regarding situations of self-assessment, in the majority of cases related to withholding tax and cases of payments on account of the final tax due, the dispute mandatorily has to begin with a claim presented to the tax authorities, except for those cases where there is taxpayer disagreement with the self-assessment, or where the withholding is only based on a matter of law and the self-assessment or the withholding was made according to general instructions provided by the tax authorities. Such cases may go directly to court within 90 days of the original assessment.

In the case of self-assessments and withholding tax, the deadline to submit the claim to the tax authorities is two years after the submission of the assessment, and in the case of payments on account of the final tax due, the deadline is 30 days from the date of the tax being wrongfully paid.

In the case of self-assessments and withholding tax, the taxpayer may appeal to court from an express or tacit negative decision of the tax authorities within 30 days from that decision. A tacit negative decision is deemed to occur if the taxpayer does not receive any decision within four months of the presentation of the administrative claim. In the case of payments on account of the final tax due, the claim is considered tacitly approved if the taxpayer does not receive an answer from the tax authorities within 90 days. In the event of denial, the taxpayer has 30 days to go to court.

iii Deadlines

In the case of assessments made by the tax authorities (e.g., after a tax inspection,² due to the automatic exchange of information, in cases of non-assessment by the taxpayer), the taxpayer may choose between lodging an administrative claim to the tax authorities within 120 days or contesting the assessment immediately in court within three months of the deadline for voluntary payment of the assessment. Normally, the deadline for voluntary payment of the assessment is 30 days following notification of the assessment. The date of the notification of the tax assessment is important, as it establishes the relevant date from which the deadlines to react must be counted. If the taxpayer opts for an administrative claim, it will have to wait for an express decision that, in the case of express rejection, may be challenged in court within 15 days or an appeal made to the Minister of Finance within 30 days. The taxpayer may also opt to consider the decision tacitly rejected within four months after presentation of the claim, in which case it may opt to go to court within 90 days or present an appeal to the Minister of Finance within 30 days. These deadlines are frequently criticised by commentators and in the case law, so it is to be hoped that in a future reform of the Tax Procedural and Process Code, the legislature will work on the harmonisation of these incomprehensibly differing deadlines.

iv Other administrative procedures

However, in addition to the above-mentioned administrative claims related to tax assessments, there are other specific tax procedures for different purposes related to taxation that have specific rules concerning deadlines. Among these are the rules regarding:

- a* access by the tax authorities to banking information and documentation;
- b* advance clearance, whereby taxpayers may request an audit and the tax authorities become bound by the conclusions reached in that audit;
- c* binding rulings³ and requests for interest due to the taxpayer;

2 Tax inspections must be completed within six months, but in certain circumstances may be prorogated for two periods, each of three months. The statute of limitations (generally four years) for assessing tax is suspended while the inspection is pending. If the tax authorities conclude that tax must be assessed as a result of the inspection, and before the issuance of a final report, the taxpayer is notified to pronounce within 15 days over the corrections proposed. If the taxpayer is able to present new facts that were not considered in the inspection, the tax authorities sometimes withdraw totally, or more frequently partially, the proposed decision.

3 Binding rulings can be requested with urgency; the taxpayer must demonstrate the urgency, present the tax treatment considered applicable and pay an amount to be determined by the tax

- d* revision of tax assessments allowed in certain cases during a period of four years after the tax assessment;
- e* determination of the taxable income by indirect methods;
- f* determination of the tax value of immoveable property and recognition of tax incentives;
- g* application of the general anti-avoidance rule (GAAR);
- h* rebuttal of legal presumptions; and
- i* a simplified procedure for the correction of material and obvious errors of the tax authorities.

v Other judicial processes

The Portuguese Constitution grants taxpayers the fundamental right of access to courts to defend their rights and legally protected interests. Consequently, at least in theoretical terms, justice cannot be denied with reference to the absence of a specific means or type of action to entitle the taxpayer to go to court. The design of the tax judicial system foresees myriad types of actions to be used by the taxpayer, depending on the issue to be decided by the court.

The most common type of action is called a 'process of judicial impugment', which is a judicial appeal against a tax assessment or against a tax authority decision rejecting an administrative claim against a tax assessment. There is also a special administrative action that is used to challenge in court the legality of acts of the tax authorities not related to the legality of a tax assessment.

Specifically in the context of tax foreclosure processes, judicial opposition may be presented by taxpayers within a period of 30 days from their notification of the beginning of the foreclosure process, citing, *inter alia*, the illegitimacy of the taxpayer being notified in the process and the judicial reclamation that may be presented against acts of the tax authorities in the foreclosure process within 10 days from the acknowledgment of the act.

Tax law also foresees precautionary actions in favour of the tax authorities, such as the seizure of assets and an option for the taxpayer to contest such seizure. Although precautionary actions in favour of taxpayers are not treated in detail in the tax process law, the jurisprudence recognises such a possibility (e.g., the suspension of the effectiveness of acts by the tax authorities), applying the rules foreseen in the administrative and civil process codes.

The law on tax process also includes actions with an ancillary scope. These are the summons to the consultation of documents and issuance of certificates, the anticipated production of proof, processes related to the derogation of bank secrecy and the process

authorities according to the complexity of the topic. If the tax authorities accept the urgency of the matter, the binding ruling will be issued within 120 days from the date of presentation of the request, and in the event that the tax authorities do not issue the ruling in such a time frame, it is considered that the tax treatment presented by the taxpayer is agreed to by the tax authorities. Normal binding rulings are free of charge and should be given within 150 days after the submission of the request. This deadline is considered merely indicative.

for the execution of judicial decisions in the event that the tax authorities do not comply voluntarily with the courts' final decisions.

In addition, within a residual scope (i.e., for cases where any of the remaining types of actions do not present a suitable means of achieving the result desired by the taxpayer), there is also an action for the recognition of a right or a legitimate interest in tax matters that has a deadline of four years from the acknowledgment of the constitution of the right, or the acknowledgment of its violation and indication for an action by the tax authorities.

Because of the variety of means available with differing scope, presuppositions, procedures and deadlines, and the respective subtleties of each action, taxpayers are strongly advised to seek professional and specialised advice concerning disputes with the tax authorities.

III THE COURTS AND TRIBUNALS

The judicial phase may also have two stages. The initial claim is normally decided by a single independent judge in a court of first instance. An appeal (to be presented by whoever loses the case in first instance – the taxpayer or the tax authorities – or by both in the event that both parties lose part of the case) may be taken to the court of appeal in the event of a disagreement with the facts and the law decided in first instance, or to the Supreme Administrative Court in the event of a disagreement exclusively based in matters of law. The appeal must be presented in the court of first instance within 10 days of its final decision, and is only precluded if the value of the case (in cases challenging tax assessments, the amount of tax in litigation) is lower than €1,251. The decisions of the courts of appeal are rendered by the majority decision of a panel of three judges.

From the decision of the court of appeal or of the Supreme Administrative Court, the taxpayer or the tax authorities may in exceptional cases still lodge an appeal to the Supreme Administrative Court based on a contradiction of a previous judgment, or go to the Constitutional Court in cases where there is a constitutional issue in the process.

If there are uncertainties as to whether a tax assessment violates EU law, the court of last instance shall file a request for a preliminary ruling to the Court of Justice of the European Union. In contrast to the court of last instance, the courts of first instance are not obliged to file such request, and the instances in which such courts have opted to voluntarily request a preliminary ruling are scarce.⁴

Currently, the majority of disputes are resolved in the court of appeal, as the party that loses the case at first instance often appeals to the court of appeal. Since the Supreme Administrative Court only deals with matters of law, fewer cases are settled in it.

4 For further developments about referrals made by Portuguese courts to the European Court, see Francisco de Sousa da Câmara, 'The meaning and scope of the *acte clair* doctrine concerning direct taxation: the Portuguese experience and the establishment of boundaries', in Ana Paula Dourado and Ricardo da Palma Borges (eds.), *The Acte Clair in EC Direct Tax Law*, IBFD, 2008.

On average, it takes around four to five years to obtain final decisions. However, this time frame is merely indicative, and while it is possible to obtain final decisions in less time, it is more often the case that it will take longer.

i Organisation of the courts

Tax disputes are traditionally covered by a special set of courts that deal with administrative and tax matters. Under the current organisation of the judicial system, there are 18 courts of first instance in different regions of the country (including Madeira and the Azores) that deal with administrative and tax matters. Lisbon is the only place where there is a specific court for tax matters alone and another for administrative matters. The territorial competence of the courts is determined by the local tax office that enacted the tax assessment, which normally corresponds to the local tax office that covers the area of the tax domicile of the taxpayer. Tax assessments of non-resident taxpayers are considered and made by the local tax office of Lisbon. The two courts of appeal are situated in Oporto and Lisbon. The Supreme Administrative Court is also located in Lisbon and covers the entire country. Both the courts of appeal and the Supreme Administrative Court have one chamber for administrative law appeals and actions, and another chamber that deals only with tax law appeals and actions.

In the tax process, taxpayers are represented by lawyers and the tax authorities by officers with a law degree.

IV PENALTIES AND REMEDIES

i Interest

In cases of late assessment, compensatory interest is in principle due at the rate of 4 per cent per year. In cases of non-payment of tax assessments, interest is due at a rate of (currently) 7.007 per cent per year. A taxpayer who does not agree with a tax assessment and decides to challenge it may opt not to pay the tax and present a guarantee while the matter is being discussed. In such cases, interest is still due at a rate of (currently) 3.503 per cent per year.

ii Criminal and administrative penalties, and civil liability

Criminal and administrative penalties as well as civil liability are foreseen in a specific law called the General Regime of Tax Infractions.

Tax infractions considered to be crimes may be sanctioned with imprisonment of up to eight years, and fines of up to 600 days that vary between €1 and €500 a day in the case of individuals; and fines of up to 1,920 days in the case of collective entities varying between €5 and €5,000 per day. Furthermore, the infractor may be subject to accessory sanctions (e.g., interdiction to perform certain activities, closing of activity).

Tax infractions considered not to be crimes may be sanctioned with administrative penalties (up to €165,000 in the case of intent and €45,000 in the case of negligence) and also accessory sanctions.

In the case of disputes related to additional tax assessments made by the tax authorities, the taxpayer will also be notified of an infraction procedure. Notwithstanding the possibility of immediately paying the administrative penalty or challenging the

decision that determined the administrative penalty on its own merits, the law foresees that this process may remain suspended until a final decision is reached in the tax dispute concerning the legality of the tax assessment. Usually, taxpayers opt for the latter alternative as, if they win the tax dispute, in principle the infraction will be annulled.

The General Regime of Tax Infractions also establishes the civil liability of the directors of collective entities in the event that the latter do not have the means necessary to pay the fines and administrative penalties to which they were sentenced. This regime of civil liability is being disputed on the grounds of its lack of conformity with the Constitution.

V TAX CLAIMS

i Recovering overpaid tax

Overpaid tax is treated in different ways depending on the reason for the tax having been overpaid.

The most common case is when taxpayers of personal and corporate income tax are subject to withholding tax or make payments on account in an amount higher than their final liability. In these situations, if the individuals and corporate bodies present their annual tax returns in due time, the tax authorities are legally obliged to reimburse the excess tax within a period of three months. If the tax authorities fail to comply with that deadline, taxpayers are entitled to interest at the rate of 4 per cent per year.

Other common situations arise when corporate shareholders resident in other Member States of the EU or the EEA only comply with the holding requirement period of the Parent-Subsidiary Directive and the Interest and Royalties Directive after the payment of dividends, interest or royalties has been made. In these situations, provided the holding requirement period is met afterwards, the non-resident beneficiary of the income may request from the tax authorities the reimbursement of the excess tax (normally within two years), and the tax authorities are legally bound to reimburse the excess tax within a certain period of time (varying between three months and one year, depending on the type of income and residence of the beneficiary); if they do not comply within this time frame, the non-resident beneficiary is entitled to interest at the rate of 4 per cent per year. A similar regime applies in cases where the non-resident beneficiary has not complied with the ancillary obligations required by Portuguese law to benefit from the said Directives or DTTs (mainly the certification of certain declarations and forms) until the income is paid by the resident entity, and only complies with those ancillary obligations and formalities afterwards. In these situations, requests to the Portuguese tax authorities to reimburse the excess tax shall be made directly by the non-resident beneficiary or, as strongly recommended, by a specialised lawyer representing it.

Other situations of overpaid tax include those where tax was mistakenly overpaid by the taxpayer. In cases of withholding tax, where substitutes deliver more tax than the tax that should have been withheld, they are in principle entitled to compensation in the next withholding. In cases where taxpayers wrongfully declare more tax than the amount due in their tax returns, they may present new tax returns if they are still within the allowed time frame to do so. Otherwise, they must lodge an appeal to the tax authorities.

ii Challenging administrative decisions

Administrative decisions may be challenged before the tax authorities or the courts on the grounds of any illegality, including an unconstitutionality, unjust situation, abuse of power, acquired right or legitimate expectation.

The tax authorities tend to give reasons to taxpayers only in limited circumstances. Furthermore, under the argument that they are bound to comply with the law, they tend not to recognise other illegalities (for instance, a violation of EU law or an unconstitutionality) besides strictly observed violations of the law.

iii Claimants

According to the Tax Procedure and Process Code (Article 9), tax claims can be brought by the taxpayer, legal substitutes, representatives, persons jointly and severally responsible, persons subsidiarily responsible, and any other persons or entities that prove an interest to be legally protected.

Regarding VAT, the VAT Code specifically mentions that the taxpayer, persons jointly and severally responsible, or subsidiarily responsible, are entitled to present claims against VAT assessments. As the VAT Code establishes that the other party in the transactions subject to VAT is jointly and severally responsible for the payment of the VAT due, this means that in practice, when an unlawful VAT charge is passed to the buyer of the goods or services, this entity may legitimately present a claim against the unlawful VAT charge.

VI COSTS

Administrative claims are free of charge. Notwithstanding, certain acts of the tax authorities are subject to costs (e.g., certificates, second valuations, urgent rulings) that are foreseen in the law or in ordinances.

Claims in courts are subject to costs. To lodge a judicial claim against a tax assessment, taxpayers have to pay an amount between €51 (for litigation with a value up to €2,000) and €816 (for litigation with a value up to €250,000). This amount is considered in the final account to be paid by the entity that loses the case. This amount is recoverable in the proportion of the victory, provided the taxpayer demands from the other party the costs paid within five days, counting from the date the decision becomes *res judicata*.

VII ALTERNATIVE DISPUTE RESOLUTION

i Tax arbitration

As mentioned in Section I, *supra*, arbitration in tax matters was introduced in 2011 as an alternative dispute resolution mechanism. According to the regime that introduced arbitration in tax matters, the tax authorities are only bound by arbitration decisions (which can be rendered by a single arbitrator or by a college of three) for almost all types of tax dispute with a value of up to €10 million.

Despite the short time that this new regime has been in existence, it is already considered a success, mainly because of the time frame in which it is possible to obtain final decisions (six months, which can be extended for a further six months) and owing to the quality of the decisions; this very positive appraisal also derives from the manner in which the Administrative Arbitration Court Centre (CAAD) is organising the administrative and procedural work, ensuring permanent access to all files by computer, and the efficient day-to-day running of the Court. However, the decision to resort to arbitration should be carefully evaluated as there are some drawbacks, mainly the fact that opportunities to appeal against a decision are greatly restricted.

In the past three years, taxpayers have already opted to litigate and dispute tax controversies under the arbitration mechanism in approximately 500 cases (in matters including thin capitalisation rules, the applicability of the GAAR, reverse mergers that may or may not benefit from tax neutrality, tax groups, issues of VAT, stamp duties and immoveable taxes, capital gains and individual income tax). The arbitration courts have already decided more than 290 cases, and the trend continues.

Judges may be former judges, professors or lawyers; current authors, tax consultants and economists, *inter alia*, appear on a list of independent persons approved by the CAAD. Several incompatibility rules do exist. Each party (the taxpayer and state) may choose an arbitrator, with a third one being chosen by the other two arbitrators or by the CAAD's Deontological Board.

Arbitration has also become an efficient route to claim back undue tax or recover taxes based on tax provisions already considered illegal by court cases; although Portuguese law does not recognise the preceding court decision as binding, usually the courts, including the arbitration courts, follow the decisions (including the reasonings) already adopted by the Supreme Administrative Court or the central administrative courts (tax sections).

VIII ANTI-AVOIDANCE

A general anti-avoidance rule (GAAR) was introduced into Portuguese law more than 10 years ago. To apply the GAAR, the tax authorities must follow a strict procedure. The extra requirements established in the law for the application of the GAAR by the tax authorities, combined with the absence of experience and tradition in Portuguese tax law with these types of clauses, has contributed to the fact that the first decision from the courts where the applicability of the GAAR was considered was only issued at the beginning of 2011.⁵

5 For a description of the functioning of the Portuguese GAAR, and a description of the facts in the above-mentioned case, in which the judicial decision gave reason to the Portuguese tax authorities concerning the applicability of the GAAR, see Francisco de Sousa da Câmara and José Almeida Fernandes, 'Portuguese branch report in Tax Treaties and Tax Avoidance: application of anti-avoidance provisions', *Cahiers de droit fiscal international*, Vol. 95a, IFA; Sdu Uitgevers, The Netherlands, 2010. For another brief description of the facts in the referred

IX DOUBLE TAXATION TREATIES

DTTs are interpreted according to the common rules of interpretation of laws and taking into due account the rules of interpretation of the Vienna Convention on the Law of Treaties that give relevance to the commentaries to the OECD Model Tax Convention.

There are specific rules for the application of DTTs. In particular, for a DTT to apply, the non-resident entity has to fill in a specific form issued by the Portuguese tax authorities and have it certified by the tax authorities of its state of residence.

Each year, several cases regarding the applicability of DTTs are decided by the higher instance courts.

In one recent example of the application of DTTs in Portuguese case law, on 7 November 2012, the Second Chamber of the Supreme Administrative Court ruled regarding two taxpayers resident in France (who were represented in court by their Portuguese subsidiary); they claimed they were entitled to the reduced rate foreseen in the France–Portugal DTT applicable to dividends paid by entities resident in Portugal to non-resident shareholders in 2000, instead of the higher domestic rate charged by the tax authorities to the resident subsidiary following an inspection during which the tax authorities discovered that the non-resident entities did not present the forms required by the tax authorities for the application of the DTT (case 626/12).⁶

i EU primary and secondary law

Similarly, a considerable number of cases have considered the compatibility of Portuguese tax law with the EC Treaty and with the direct tax and VAT Directives. In a recent example, on 29 February 2012 the Supreme Administrative Court ruled in a case related to the payment of dividends in 2005 and 2006 by a Portuguese subsidiary to its shareholder resident in Spain (case 1017/12). The non-resident taxpayer claimed that there was a difference in treatment between resident and non-resident taxpayers. While in a domestic situation Portuguese law required that the shareholder, to avoid withholding tax on the payment of dividends, had to have a participation of at least 10 per cent held uninterruptedly in the year prior to distribution, in the case of non-resident corporate shareholders, Portuguese law in force at the time required a minimum holding of 20 per cent held uninterruptedly in the two years prior to the distribution of dividends. The non-resident taxpayer claimed that this difference in treatment amounted to a discrimination forbidden by Article 58 of the EC Treaty. The Supreme Court ruled that this difference in treatment would not violate the free movement of capital only if it could be demonstrated that the tax withheld at source in Portugal could be credited

case, see Bruno Santiago, Inês Salema and Rita Carvalho Nunes, 'Update on Intercorporate Dividends, GAAR, Arbitration', *Journal of International Taxation*, October 2011.

6 For an example of a case related to the deductibility of interest charges between the permanent establishment of a bank located in Portugal and its head office located in France, as well as regarding withholding tax levied on that income, see Bruno Santiago, 'Court rules on w/h tax on interest payments between PE and general enterprise', *Journal of International Taxation*, May 2008.

against the tax due by the non-resident shareholder in Spain. As the proceedings did not clarify the tax regime applicable in Spain, the Court ruled that the file had to return to the court of first instance to determine the tax regime applicable in Spain.

ii VAT

Generally, taxable persons with an annual turnover of less than €10,000 are exempt from VAT on their supplies of goods or services.

If the taxpayer has assessed less tax than the tax due, it is obliged to correct the tax assessment with no time limitation. However, if the taxpayer has assessed more tax than the tax due, the correction of the VAT return is optional and has to be presented within two years after the presentation of the original return.

X AREAS OF FOCUS

The majority of cases that end up in court are related either to foreclosure processes or to corporate income tax and, in particular, the non-recognition of certain costs for corporate income tax purposes by the tax authorities. Nonetheless, there are some pending cases related to more cutting-edge topics, such as controlled foreign corporations, transfer pricing and GAAR.

Also, the thin capitalisation regime that was applied only to financial transactions with related entities located outside the EU (notwithstanding the possibility of applying the transfer pricing regime in intra-EU situations)⁷ was revoked and substituted by a general limitation on the deductibility of net financial charges applicable to both related and non-related parties. According to the new regime, and in line with what is being implemented in other jurisdictions (e.g., Germany and Italy), the deductibility of net financial charges is now linked with the EBITDA of the corporate taxpayers (resident corporate entities and permanent establishments of non-resident entities). This new regime does not apply to the net financial charges of financial and insurance institutions.

According to the new regime, interest and other accessory costs paid in relation to financing activities are fully deductible until the higher of the following limits: €3 million or 30 per cent of the EBITDA. Taking into account the fact that traditionally companies in Portugal were financed mainly with debt to the detriment of equity, the law establishes a transitional regime from 2013 until 2016, whereby the threshold linked with the EBITDA is 70 per cent in 2013, 60 per cent in 2014, 50 per cent in 2015 and 40 per cent in 2016. Non-deductible net financial charges may be carried forward to one of the following five years and deducted together with the interest paid in that year, provided the said limits are not exceeded. In the event that the interest paid in a given year is below the said EBITDA limit, the difference may also be carried forward to one

⁷ For a recent example of a court of appeal referring a case for a preliminary ruling to the Court of Justice of the European Union regarding the compatibility of the Portuguese thin capitalisation regime with the free movement of capital, see Francisco de Sousa da Câmara and José Almeida Fernandes, 'The Applicability of Portuguese Thin Capitalization Rules to Third Countries', *Tax Notes International*, 22 October 2012, Tax Analysts 2012.

of the five following years. In relation to tax groups, these limitations on deducting net financial charges apply to each company of the group.

However, following a profound reform of the corporate income tax regime, enacted on 1 January 2014, a new set of rules will apply. Although designed to make this tax simpler and more transparent and competitive, it still remains to be seen whether litigation will be reduced or not. The law journals indicate that this objective will be obtained. However, the confirmation that the tax authorities and the taxpayers both have the same view, and that the law in practice will realise those goals, are among the most moot and crucial points of this reform.

XI OUTLOOK AND CONCLUSIONS

Given a perceivable trend noted in 2012 and 2013 towards a more combative attitude on the part of the tax authorities, both at the pre-litigation stage and when cases reach the courts, we would recommend that taxpayers take more preventive and proactive steps to safeguard their interests.

Appendix 1

ABOUT THE AUTHORS

FRANCISCO DE SOUSA DA CÂMARA

Morais Leitão, Galvão Teles, Soares da Silva & Associados, RL

Francisco de Sousa da Câmara joined the firm in 1986 and became a partner in 1991. He coordinates the tax teams of the Lisbon and Madeira offices.

Mr da Câmara represents major corporations and multinationals in tax restructuring operations dealing with different types of taxes, as well as matters related to the application of double taxation treaties and EC tax law.

He has also actively worked in the areas of transfer pricing, in both the drafting of agreements and litigation before the tax authorities and tax courts, the taxation of derivatives and financial products, securitisation and the structure of international operations using the International Business Centre of Madeira. Tax litigation also plays a significant role in his professional activities, in which he leads a team of lawyers with over 200 judicial and administrative cases, dealing with a wide range of tax issues.

Mr da Câmara was a member of several committees of experts in charge of drafting tax legislation, including the Judicial Procedural Tax Code and the General Tax Law.

He is also a visiting professor of international tax law at Nova University of Lisbon, and author of several articles published on tax subjects. He is the correspondent in Portugal for the *International Bureau of Fiscal Documentation*, *Tax Analysts* and the *EU Tax Journal*.

He is a tax arbitrator at the Administrative Arbitrage Centre and a member of the independent list of persons of standing in the ambit of the Convention on the Elimination of Double Taxation in connection with the adjustment of profits of associated enterprises (Arbitration Convention).

He was admitted to the Portuguese Bar Association in 1988, and is the chair of the Portuguese Association of Tax Consultants and a member of the Portuguese Tax Association. He is also a member of the International Fiscal Association, the European Association of Tax Law Professors and the *Confédération Fiscale Européenne*.

He gained his law degree from the Faculty of Law of the Catholic University of Portugal in 1986, and commenced his postgraduate studies in EU law at the Law Faculty of the Catholic University of Portugal in 1987. He gained a master's degree in tax and financial law from the Faculty of Law of the Catholic University of Portugal in 1992. He has been awarded the title of specialist lawyer in tax by the Portuguese Bar Association.

He speaks Portuguese, English and French.

ANTÓNIO LOBO XAVIER

Morais Leitão, Galvão Teles, Soares da Silva & Associados, RL

António Lobo Xavier became a partner in 2006. He heads the tax team at the Oporto office.

From 1989 to 2005, he practised law at Osório de Castro, Verde Pinho, Vieira Peres, Lobo Xavier e Associados – Sociedade de Advogados.

He works with large national and multinational companies, in the areas of finance, telecommunications and industry, as a member of the board of directors and as an adviser on finance and tax law. He is responsible for several organisational and restructuring operations, and mergers and acquisitions, mainly as an expert in subjects relating to double taxation treaties, VAT and corporate income tax.

Mr Lobo Xavier has also actively intervened in several arbitration proceedings. He acts as an arbitrator at the Administrative Arbitration Centre. He was a member of the Portuguese parliament at various times between 1983 and 1996, and was the leader of his party's parliamentary group between 1992 and 1994.

He has been a visiting professor in public finance and tax at several Portuguese universities.

Mr Lobo Xavier was a member of the Fiscal Reform Commission of 1988 and president of the Fiscal Reform Commission of Corporate Income Tax in 2013.

He is a member of the Portuguese Bar Association (admitted in 2005) and was a member of the Superior Counsel of the Administrative and Fiscal Courts between 1986 and 1991. Further, he is a member of the consultative board of ACEGE – the Association of the Managers and Catholic Entrepreneurs; a member of the board of the Commercial Association of Oporto; a member of the board of Fundação de Serralves; and an arbitrator at the Administrative Arbitration Centre.

He gained his law degree from the Faculty of Law of the University of Coimbra in 1982 and also his master's degree in law and economics in 1988.

He was awarded the title of specialist lawyer in tax by the Portuguese Bar Association in 2004.

He is the author and co-author of several articles on tax published in professional journals.

He speaks Portuguese, English, French and Spanish.

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