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Portugal faces uphill battle against tax avoidance despite new measures

António Pedro Braga of Morais Leitao Law Firm evaluates the merits of GAAR developments in Portugal

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In this time of uncertainty about the effects of general confinements, an old and wise piece of advice is being heard in many discussion *fora*: "one should avoid killing the patient to cure the disease". To which we could add: "especially when the actual disease may be difficult to identify".

This is an apt motto for a brief reflection on one of the newest and harshest tax measures on the fight against tax avoidance that, like many tax administrations, the Portuguese tax authority (PTA) has been waging for more than a decade. The legislation in this domain is one of the most advanced, and a 20-year old general anti-abuse rule (GAAR) and a decade-long law on the advance reporting of so-called 'tax avoidance schemes', a precursor of Directive 2018/822 of May 25 2018, (DAC 6) are there to prove it.

It is almost a truism to say that the application of any anti-abuse provisions, especially the GAAR, besides demanding a full technical understanding of the possibly abusive situations, requires great experience in tax matters, a solid legal background and an unbiased mind. In our opinion, the Portuguese case law on tax abuse has too often failed as a paradigm of these virtues.

Two simple examples can very easily illustrate this: (i) even the higher courts have in many occasions been incapable of discerning between a transfer pricing problem and a re-qualification problem (typical of the GAAR) and (ii) the same instances (namely the arbitral courts) have issued contradictory judgments on not so complex questions such as whether a conversion of a type of company into another to obtain a tax advantage meets the requirements to apply the GAAR. The PTA has seized on this lack of consistency and has pushed ahead with much more litigation in this area.

A recent change in the GAAR brings new and potentially very dissuasive ammunition to the PTA and may present a real threat even to those taxpayers which may only be choosing the most tax efficient of two legitimate alternatives. Law 32/2019 of May 5, introduced an aggravated interest penalty applicable to situations declared to be abusive by the tax courts: 15 percentage points on top of the general 4% yearly interest rate on delayed tax assessments, which means that for every year since the time when the abusive scheme produced tax effects, the taxpayer will pay 19% on the alleged tax saving. As additional tax assessments based on abuse tend to be notified only three or four years after the alleged abuse, the newly aggravated interest could easily reach 60 to 70% of the tax savings.

This penalty may be much higher than any pecuniary penalty foreseen in the General Regime of Tax Infractions (RGIT), which contains not only the definitions and the sanctions for almost all tax infractions, but also important provisions on the mitigation and even the waiver thereof, which can happen when the taxpayer immediately pays the penalty, shows a low degree of guilt and does not give rise to an effective revenue loss. The RGIT also foresees two very important general limitations on pecuniary tax penalties: the possibility to pay the lowest amount of the penalty range, in the case of an early payment, and the maximum abstract penalty of €165,000 ($179,650) per infraction (applicable to intentional infractions).

However, the provision on the aggravated interest rate - which very clearly has a wholly punitive nature, in the sense that it does not aim to compensate the tax administration for any loss in revenue – besides not having been inserted in the RGIT appears to be materially independent from it. In fact, Article 38(6) of the General Tax Law, where the penalty interest is foreseen, stipulates that it applies "without prejudice of the RGIT", which most surely will not be interpreted by the PTA as an embracement, in the GAAR, of the aforesaid general limitations and guarantees laid down in the RGIT but, on the contrary, as an injunction to cumulatively apply the interest penalty and the sanctions foreseen in the RGIT.

It follows that a potential situation of abuse may be even more onerous, penalty-wise, than a straightforward omission to pay tax (for instance, a deduction of a cost which is not tax deductible), either intentional or not. This outcome is dangerous and potentially very unfair but reflects the existing tax *zeitgeist*: the grey area of tax avoidance is becoming an area of crime and punishment and financial intimidation appears to be the silver bullet. In the meantime, the right to manage one's taxes may go into an indefinite quarantine.

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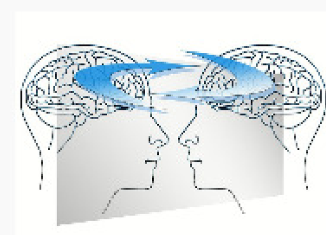

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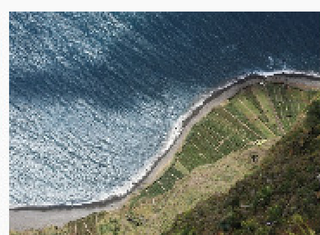

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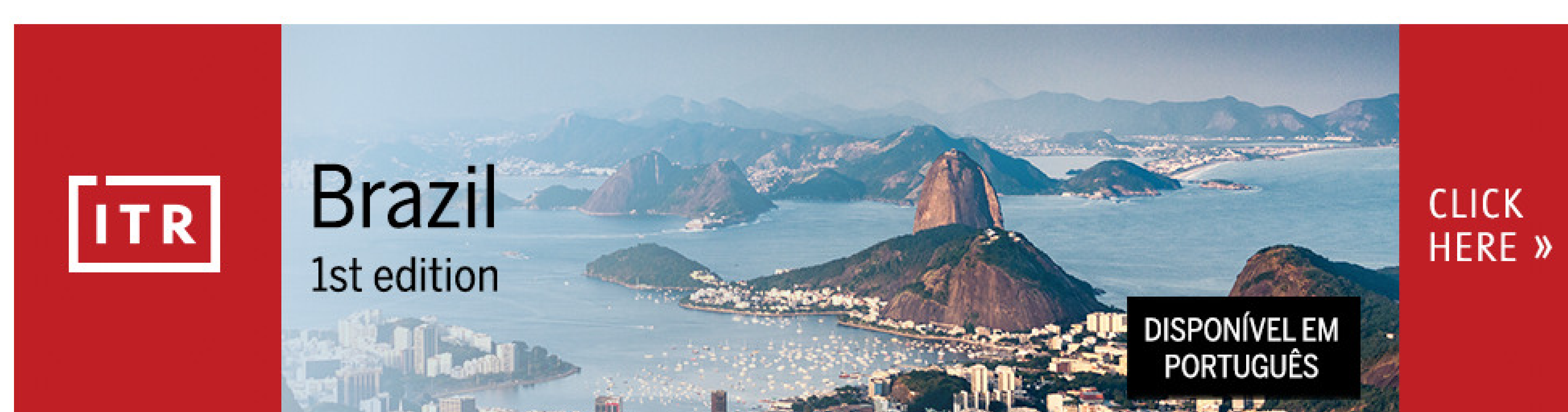

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