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8TH OCTOBER 2024

PORTUGUESE ARBITRATION COURT SETS LIMITS TO TAX ANTI-ABUSE RULE

The Portuguese Arbitration Court has ruled on applying the general anti-abuse rule to a sale of shares where the purchase price was paid using the profits distributed by the target company. The Tax Authorities considered this transaction abusive and denied the exemption on the profits; the Court concluded that there were no grounds for taxing such profits.

The Portuguese Arbitration Court recently ruled in a case where the Portuguese Tax Authorities deemed a transaction abusive and applied the general anti-abuse rule (Case 498/2023-T).

Under the Portuguese general anti-abuse rule, set out in Article 38 of the General Tax Law, the Portuguese Tax Authorities have the power to tax transactions whenever they involve abusive practices, i.e., transactions carried out with the primary purpose of avoiding or reducing taxes through the misuse of legal forms.

This case concerned the transfer of shares of Company A to another entity, Company B, which had been recently incorporated. Company B had no operational activity and lacked the financial means to pay the purchase price for the shares. According to the Tax Authorities, Company B was created solely for the purpose of holding the shares of Company A.

The share purchase and sale agreement stipulated that the payment for the shares would be made once Company B received the profits from Company A that had been recorded prior to the share sale.

The transaction enabled Company B to benefit from the participation exemption on the profits distributed by Company A, while the sellers took advantage of a capital gains exemption on the purchase price received from Company B.

The Tax Authorities deemed the transaction abusive, as it was executed through artificial means and involved the misuse of legal forms with the intent to avoid taxes. Consequently, they applied the general anti-abuse rule and taxed the sellers on the profits they would have received had they not sold the shares in Company A to Company B.

The Arbitral Court ruled that there was no legal basis for applying the anti-abuse rule and annulled the tax assessment on the following grounds:

- A company that holds shares in another company, even without operational activity, still conducts economic activity, albeit indirectly;
- The transactions carried out by the shareholders had economic substance and were conducted following the law, meaning they could not be considered abusive; and
- The outcome of the sellers' decisions does not contradict tax law, as both the capital gains exemption and the participation exemption are provided for within the legal framework.

Finally, the Court concluded that choosing a more favourable tax route is simply an expression of private autonomy. If it adheres to the tax system, it cannot be regarded as an abusive practice.

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