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## GENERAL ANTI-AVOIDANCE CLAUSE: THE FIRST JUDICIAL DECISION

The first decision by a superior court, made unanimously, on the application of what is known in Portuguese as a *cláusula geral anti-abuso* or general anti-avoidance clause, was handed down recently. This is judgment number 4255/10, of 15 February 2011 by the Central Administrative Court – South (TCAS).

The general anti-avoidance clause was introduced to our legal system in 1999 by the General Taxation Law. This law determined that, in terms of taxation, acts or legal transactions are ineffective if they are essentially or principally intended, using cunning or fraudulent means and abusing the legal framework:

- a) to reduce, eliminate or delay the payment of taxes that would be due as a result of facts, acts or legal transactions with an identical economic goal, or
  - b) to obtain tax advantages that would not be obtained, in whole or in part, without using these means.
- In these cases, and faced with the ineffectiveness of such transactions, the taxation of income that comes from them is done in accordance with the rules applicable in their absence so that they do not produce the intended tax advantages.

During the 90s, and influenced by Europe, Portugal also began to progressively adopt some anti-avoidance measures. In addition to the general anti-avoidance clause –

which can, in the abstract, be applied to any operation or legal transaction that meets the requirements set out in the rule in question, in order to determine its ineffectiveness – specific anti-avoidance rules were also introduced. These specific rules targeted certain specific transactions that the legislature also identified as being abusive or anomalous. Examples of this are the rules on transfer pricing and thin capitalisation to be found in the Corporate Income Tax Code.

The reasoning behind both the specific anti-avoidance rules and the general anti-avoidance clause lies in evasive or fraudulent behaviour on the part of taxable persons in respect of tax issues and also, in the need to establish means of reaction that are adequate to guaranteeing compliance with the principle of equality in the sharing of tax burdens. A further part of the reasoning lies in seeking to satisfy the financial needs of the State and other public bodies. In practice, in most cases the tax authorities ended up choosing to apply these specific anti-evasion rules as they make provision for the reversal of the burden of proof. This is contrary to what happens with the general anti-avoidance clause where the procedural rule in the Tax Procedure and Proceedings Code provides that it is for the tax authorities to prove that the requirements that trigger the consequences set out in the said general clause have been met.

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It is in this context that the February judgment of the TCAS takes on great relevance with its ground-breaking decision finding in favour of the tax authorities' claim.

It is perhaps for this reason that, up to the publication of this recent decision of the TCAS, there have been very few cases in which the tax authorities have tried to apply the general anti-avoidance clause. This has meant that the clause came to be seen as (very) difficult to apply. As a consequence this has diminished the preventative character of the clause. It is certain that there has been an attempt to turn this situation around with the publication by the tax authorities of what are known as abusive tax planning schemes under the respective Decree-Law. However, the tax authorities have ended up almost always referring to the possible application of specific anti-avoidance rules in detriment, once again, to the far more generalised application of the general anti-avoidance clause.

It is in this context that the February judgment of the TCAS takes on great relevance with its ground-breaking decision finding in favour of the tax authorities' claim. The court held that the facts as appearing in the pleadings amount to an obvious case of tax evasion that meets all the requirements for the application of the said general anti-avoidance clause. In effect, in the situation in question, the court came to find that the requirements for the application of the anti-avoidance clause had been met and held that there was an artificial transaction aimed exclusively at minimising or eliminating taxes that would be payable if this transaction had not been carried out. In the case in question, the court found that the taxpayer exceeded the limits of freedom of business management - which are, precisely, those of "subsistence and maintenance of the tax system" - for tax reasons. This was based on the fact that the acts or transactions carried out - which involved the interposition of a corporate structure with its registered office in the Madeira Free Zone to finance a number of group companies

- being essentially or principally aimed at transforming interest into dividends. This approach would escape taxation through the application of the rules on elimination of economic double taxation of distributed profits currently provided for in the Corporate Income Tax Code.

However, in the case in question, the court also made a pronouncement on whether or not the expiry period of three years - now contained in the Tax Procedure and Proceedings Code - that is applicable to the specific procedure of the application of the general anti-avoidance clause had passed. In the end, on this issue the court accepted the step transaction doctrine according to which the anti-avoidance provision can and must be applied at the decisive and final moment that is represented in this case by the receipt of financial gains as deductible dividends instead of interest. The acceptance of the said doctrine allowed the court to conclude that the inspection procedures were started in time or, in other words, before the three year period had expired. This was despite the fact that the loan contracts had been made in 1996 and 1997 and the proceedings for the application of the general anti-avoidance clause were only started in 2004.

This judgment of the TCAS represents a new stage in the application of the Portuguese general anti-avoidance clause and in the fight against evasive and fraudulent behaviour by taxpayers. For this reason we believe that, following its publication, the tax authorities have gained a new impetus in their attempts to apply this general anti-avoidance clause and we expect to see such application increase in the current economic and, particularly, taxation situations in which the pressure to obtain income from taxes appears inevitable.

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