Meio: Bloomberg Tax
Data: 02/07/2020

Daily Tax Report: International

The Portuguese tax arbitration system has reduced the time taken to resolve disputes.
Photographer: Pau Barrena/Bloomberg

INSIGHT: Tax Arbitration–the Portuguese Experience

July 2, 2020, 8:01 AM

Listen

The tax arbitration system was introduced in Portugal with the aim of improving speed and flexibility in the resolution of disputes between taxpayers and the tax authority. Rogério M. Fernandes Ferreira of RFF & Associados describes how the system works and assesses its success in meeting expectations since its introduction.

Rogério M. Fernandes Ferreira
RFF & Associados

Tax arbitration has been implemented in Portugal since 2011, following several years of discussion among scholars and legislative bodies about its accordance with the Portuguese constitution. The most conservative legal voices considered the implementation of this mechanism with some initial concern and skepticism, arguing that the resolution of disputes between taxpayers and the tax authorities was not compatible with the institution of arbitration as a private dispute resolution mechanism. Notwithstanding, those arguments were rebutted and the possibility to commit tax disputes to arbitration was introduced.

Highlights of the Arbitration Regime

Briefly, we may define tax arbitration as an alternative mechanism of dispute resolution, through neutral and impartial third parties—the arbitrators—whose decision has the same legal value as judicial decisions issued by tax courts.

To comply with the principles of independence and equity, the implementation of this mechanism included the creation of a Tax Arbitration Center (CAAD) that, among other functions, conducts proceedings and manages the constitution of the arbitration courts, through the ethics committee.

The arbitrators are appointed by the ethics committee of CAAD from a pre-defined list of academics, tax consultants, tax lawyers and former judges, and are selected by the ethics committee based on their background and their tax experience. Arbitrators are highly qualified professionals who are able to provide a more technical approach to the cases submitted to them than that applied by the judges in the lower judicial tax courts.

Rules were put in place to ensure that the arbitrators do not have any personal or business interest in the cases they are appointed to decide.

With the introduction of tax arbitration, the government sought to strengthen the effective protection of the legally protected rights and interests of taxpayers, as well as to increase promptness in resolving disputes between taxpayers and the tax administration. This mechanism was also introduced as a way to reduce the influence of administrative and tax proceedings in the judicial (traditional) tax courts.

In this context, according to the official information made available, in the first quarter of 2019 the tax arbitration system saw an increase in the number of cases, with a further 82 cases having been filed than in the corresponding period of 2018, anticipating additional growth. The same data also show that in about 60% of cases the dispute is resolved (totally or partially) in favor of the taxpayer, and 40% in favor of the tax administration.

With reference not only to published decisions but also to the periodic statistics published by CAAD, the figures show that most disputes committed to tax arbitration relate to corporate income tax. These numbers show that companies are more likely to choose this mechanism to settle their disputes with the tax authorities, and this can be explained by a number of factors, ranging from the costs associated with this mechanism (higher than judicial fees) to the average time to have a decision settling the matter (six months to a year). In this context, companies are more willing to accept the higher cost and have a decision issued in a matter of months, than to submit their pleas to a judicial tax court that can take years to issue a decision.

Recognition of Tax Arbitral Court by the ECJ

On the implementation of this mechanism, one of the questions that arose was whether the arbitral courts operating under this regime would be qualified as a Portuguese “jurisdictional body” for the purposes of the European Court of Justice (ECJ) within the rules established to access the preliminary ruling procedure. If so, the arbitral courts would be considered as a fully capable alternative to judicial tax courts.

This question was solved, in 2014, by the ECJ, in a case known as the "Ascendi" decision, (Case C-377/13) in which the court ruled in favor of the admissibility of requests for preliminary rulings submitted by the Portuguese Tax Arbitral Court.

Although the decision issued by the ECJ did not represent an unexpected result, since the characteristics of the Tax Arbitral Court and the interpretation that had been sustained by the ECJ concerning the preliminary ruling pointed to this favorable outcome, this decision clarified an issue that had surrounded the arbitration regime from its introduction in 2011.

The Treaty on the Functioning of the European Union (TFEU) establishes the ECJ's competence to decide, on a preliminary basis, on the interpretation of the treaties, as well as on the validity and the interpretation of the acts adopted by the institutions, bodies, offices or agencies of the EU, whenever an issue of this nature is raised before any "jurisdictional body" of one of the member states and such "jurisdictional body" asks for the intervention of the ECJ.

The question thus arose whether the Tax Arbitral Court could qualify as a Portuguese "jurisdictional body" for the purposes of the application of this TFEU provision and, consequently, whether the issues raised before the arbitral tax proceedings could be the object of preliminary rulings sent to the ECJ.

Under the terms of the preamble of the legal act that established the tax arbitration regime, the Portuguese legislature had no doubt as to the possibility of presenting preliminary rulings before the ECJ, within the context of arbitral tax proceedings. Notwithstanding, the question remained whether the ECJ would consider itself competent to issue decisions on preliminary rulings presented by the Tax Arbitral Court. This means that it was necessary to obtain a decision from the ECJ itself as to whether the Tax Arbitral Court would qualify as a Portuguese "jurisdictional body."

In this regard, it should be noted that the ECJ had already ruled in the past on the admissibility of preliminary rulings presented by arbitral courts from the member states (in matters other than tax).

Taking into account the ECJ's case law, and in order for an entity of a member state to qualify as a "jurisdictional body," the ECJ has considered a number of elements, such as the legal origin of the entity, its permanence, the binding nature of its jurisdiction, the adversarial nature of the procedure, the application by such entity of the law (not equity), as well as its independence.

In the Ascendi decision, the ECJ considered that the Tax Arbitral Court met all these elements, thus qualifying as a "jurisdictional body" for the purposes of addressing preliminary rulings to the ECJ. In fact, the ECJ considered that the Tax Arbitral Court was legally based, within the Portuguese Constitution and the tax arbitration regime, under which the legislator foresees that tax arbitration is an alternative means of dispute resolution on tax matters.

The ECJ Decision also held that the Tax Arbitral Court fulfills the requirement of permanence for the purposes of qualifying as a resolution jurisdictional body, since, although the composition of the court is ephemeral and its activity ceases after a decision is issued, the Tax Arbitral Court has, on the whole, a permanent character as part of the dispute resolution system.

In respect to the binding character of the Tax Arbitral Court, the ECJ considered that, although there is no obligation, either in law or in fact, under which the involved parties should entrust their dispute resolution to arbitration, and despite the fact that the composition of the Tax Arbitral Court does not depend on an agreement between parties, the decisions issued by arbitral courts are binding in character, in particular with regard to the tax and customs authority, which means that this element is also present (as it was present in the "Merck Canada Inc." decision (C-555/13), of February 13, 2014).

With regard to the guarantee of the right of rebuttal (*principio do contraditório*), the ECJ considered that such guarantee derives expressly from the legal decree which introduced the tax arbitration regime.

On the other hand, the ECJ has also held, in the Ascendi decision, that the Tax Arbitral Court issues its decisions in accordance with the existing law, and pursuing criteria of strict legality, and is unable to issue any decision based on equity, pursuant to the tax arbitration regime.

With regard to the independence of the Tax Arbitral Court, the decision confirmed that not only are the tax arbitrators legally subject to the principles of impartiality and independence, but that the tax arbitration regime also envisages cases of impediment of the exercise of the functions of tax arbitrator, such as any family or business connection between the tax arbitrator and any of the parties in the dispute; thus ensuring that the Tax Arbitration Court is in fact a third party in relation to both sides in a dispute.

Finally, the Ascendi decision confirms that the decisions issued by the Tax Arbitral Court are jurisdictional, being assimilated to the decisions issued by the administrative and tax courts.

In light of the above, it follows very clearly from the Ascendi decision that the Tax Arbitral Court meets all the elements deemed essential by the ECJ for the purpose of qualifying as a "jurisdictional body" of a member state. This decision, aside from its importance in clarifying the question, in our opinion helped to build trust in the regime and contributed to an increase in the number of cases committed to this alternative mechanism.

Currently, six years after the Ascendi decision, it is safe to say that the arbitral courts have no reluctance in submitting cases for preliminary ruling before the ECJ, especially in matters related to the interpretation of value-added tax (VAT) rules. In this context, we have preliminary rulings submitted by the arbitral courts on VAT issues such as VAT on the indemnities charged by telecommunications companies, of which the MEO decision (C-295/17) is an example, as well as decisions on VAT regularization rules related to immovable property operations, in the case of Imofloresmira (C-672/16).

Final Remarks

It can be said that the Portuguese experience regarding arbitration in tax matters has been a good one, considering all the doubts raised about applicability and legality from a constitutional standpoint.

The implementation of a legal framework to enable arbitration in tax matters has placed Portugal in the vanguard within Europe. In fact, Portugal is, apart from the U.S., one of the few countries with experience in this area.

Naturally, time has revealed some weaknesses and there is a range of matters that must be improved; namely, regarding appeals and harmonization of tax decisions on identical tax issues, which has recently been modified.

However, we may say that the system has lived up to the expectations on which its implementation was based: the tax arbitration regime has been able to resolve a dispute in an average period of six months to a year, and shows greater flexibility regarding procedural formalities.

For this successful implementation and development, the position of the ECJ made an important contribution, through the recognition of the arbitral court as a jurisdictional body of a member state for the purposes of access to the preliminary ruling.

Arbitration in tax matters is now a well-established tax dispute mechanism and, since its implementation, has seen an increase in cases. We are therefore certain that this innovative Portuguese tax experience could be a valid contribution in the implementation of this type of alternative dispute resolution mechanism in other legal jurisdictions, especially those jurisdictions based on the Portuguese legal system in which the tax arbitration mechanism has not yet been introduced.

Rogério Fernandes Ferreira is a Partner with RFF & Associados.
He may be contacted at: rogeriofernandesferreira@rffadvogados.pt

The author would like to thank the RFF lawyers who contributed to this article.