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Constitutional Court decisions reassure corporate taxpayers

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Introduction

The Constitutional Court plays a major role in the protection of legal certainty and the expectations of corporate investors.

In a time when corporate investment is struggling with the legal uncertainty deriving from systematic changes to the Portuguese tax system, the Constitutional Court plays an important role in reassuring corporate taxpayers that the most basic constitutional principles are respected, thus protecting their investments.

Recent cases

Three recent cases brought before the Constitutional Court were ultimately decided in favour of the protection of the legitimate expectations of investors and the judicial interpretation and application of the law.

In the first two cases, two innovative rules were introduced to the Corporate Tax Code by the State Budget Law 2016 that triggered a potential increase of the corporate tax due, with a twist: by assigning an interpretative character, the rules were ascribed retroactive effect. The pretext for this was the controversy surrounding the subjects of cases in the tax courts, especially in arbitration tax courts. The legislature introduced the following rules in this regard:

- The first rule, purportedly for the sake of clarification, established that there can be no deductions from tax assessed under the application of the autonomous tax rules (neither a deduction of corporate tax benefits nor the deduction of amounts previously paid by the taxpayer as special payments on account of the final corporate tax due).
- The second rule, purportedly for the sake of clarification, determined that the increase of autonomous tax rates in the case of tax losses, where there is a tax group of companies, should apply when the tax result of the tax group itself is a tax loss (as opposed to being triggered by tax losses of the individual company subject to autonomous tax).

The main problem was that in addition to introducing these new rules, the State Budget Law 2016 ascribed them interpretative character. This meant that the new rules applied to past events. An appeal was brought before the Constitutional Court claiming that these self-denominated interpretative rules were a violation of the prohibition of retroactive taxes and that such retroactive action was problematic in light of the principle of judiciary pre-eminence in the task of interpreting and applying the law.

In a third case, the question brought before the Constitutional Court was whether legitimate expectations were worthy of protection in a case in which, although technically there was no retroactive application of a new rule, it affected the present and future use of tax benefits acquired in connection with past investments. Under the new rule, corporate tax credits (eg, tax credits deriving from the Tax Scheme for Investment Support) could from then on be used against only 10% of the corporate tax assessed each year as opposed to 25%, as was the case previously, even if such tax benefits had been acquired in previous years (as a result of investments made in previous years).

Constitutional Court decisions

With respect to the first two cases, the Constitutional Court decided that the rules of the State Budget Law 2016 were unconstitutional, due to a violation of the prohibition of the retroactivity of taxes under constitutional law.

In both situations, the Constitutional Court concluded that a self-designated interpretative rule is in fact a new law when there is controversy about the meaning of the earlier law or even when there is more than one possible interpretation of the earlier law. Since the self-designated interpretative rule always excludes one or more possible meanings of the earlier rule in favour of one elected by Parliament, this changes the effect of the earlier rule.

The Constitutional Court found that the interpretative rules at stake were innovative (since there was already judicial controversy as to the meaning of the earlier rule). As the meaning elected by the interpretative rules resulted in an increase of the corporate tax due for past years, it was incompatible with the constitutional prohibition of retroactive taxes.

As for the third and most recent case, the Constitutional Court also decided in favour of the protection of the legitimate expectations of the corporate investors, denying Parliament the right to reduce the percentage of the corporate tax assessed each year available to be offset against tax credits acquired in previous years by investments made in previous years. The public interest connected to the objective of increasing the corporate tax revenue could and should be achieved by other means that do not frustrate the trust of investors. The Constitutional Court observed that the state has a duty to respect its commitments and that the trust of investors should be protected. The court considered that a situation in which the state induces taxpayers to invest by granting them tax credits (a public goal to invigorate the economy) and afterwards changes the implicit agreement in a way that can jeopardise the effective use of the acquired tax credit is not appropriate. If the tax available annually is to be reduced, something should be given in exchange (eg, extending the limitation period for the use of the tax credits).

Comment

The Constitutional Court gave a clear and effective signal that notwithstanding public financial difficulties, the discipline and applicability of some fundamental principles and values cannot be put aside. It reinforced its role in the protection of the rights of investors and taxpayers in general, communicating the important message to all involved in the legislative process that the need to obtain tax revenue cannot be pursued at all costs and must be reconciled with the principles of non-retroactivity of taxes and of the protection of legitimate expectations, including the trust of investors.

For investment in Portugal, and thus for the Portuguese economy as a whole, including its public finances, these were reassuring judicial decisions.

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