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# Court rules on depreciation and amortisation of submerged lands within concession agreement



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The South Administrative Central Court recently discussed the problem of the admissibility, for accounting and tax purposes, of the depreciation and amortisation of submerged lands within a concession agreement between a company (the concessionaire) and the Portuguese state relating to the use of a public hydro domain for watering and hydroelectric exploitation.

## Facts

The concessionaire had signed a concession agreement with the Portuguese state which granted the company the exclusive right to manage, for a 75-year period, a certain multi-purpose project that included the use of a public hydro domain for watering and hydroelectric exploitation.

Under the concession agreement, the concessionaire was considered the owner of certain land and property allocated to the concession for the entire duration of the contract, since the respective acquisition costs were borne by the company. Notwithstanding this fact, the land and property would revert to the Portuguese state upon the termination of the contract. Under the terms of the concession, the concessionaire's revenue corresponded to the tariffs charged for the private use of hydric resources as well as the administrative charges due for granting use licences.

The concessionaire addressed a request to the Portuguese Tax Administration (PTA) as it intended to use an amortisation method different from that foreseen in the Portuguese legislation. The PTA's response included a reference to the fact that, even though the company considered that the submerged land within the concession agreement should also be subject to amortisation, the PTA had the different opinion that the submerged land should not be subject to depreciation and therefore its amortisation would not be admissible for tax purposes.

The concessionaire was later subject to a tax audit in which an increase was made to the company's taxable profit corresponding to the amounts relating to the amortisation of the submerged land.

Since the subsequent administrative claim filed by the company received a negative answer from the PTA, the company decided to submit a judicial claim, which was also denied at first instance by the administrative and tax court.

As a result, the company appealed to the South Administrative Central Court which analysed the accounting and tax regime applicable to submerged lands within a concession agreement in order to determine whether the respective amortisation was admissible for corporate tax purposes.

### **PTA position**

The PTA sustained that, despite the fact that it had acknowledged that the submerged land was part of the concession agreement, the nature of the submerged land as a non-amortisable asset had not changed. It further held that the relevant element to determine whether a certain asset should be depreciated and thus subject to amortisation corresponded to the nature of the asset and not to other elements, including:

- the nature of the landowner;
- the type of contract being questioned; and
- the conditions set out therein.

Therefore, the PTA concluded that submerged land could not be depreciated due to its own nature and that its amortisation was inadmissible for corporate tax purposes.

### **South Administrative Central Court decision**

The South Administrative Central Court acknowledged that the concessionaire had incurred acquisition costs with the submerged land, and that such land was part of the public service concession agreement and deemed to revert (ie, to be transferred) to the Portuguese state at the end of the contract without charge.

Bearing this in mind, the court considered that the International Financial Reporting Interpretations Committee (IFRIC) 12 – Service Concession Arrangements should apply to this case.

Taking IFRIC 12 into consideration, the court concluded that the concession agreement at stake corresponded to the intangible asset model, under which the operator receives an intangible asset (ie, a right to charge for the use of a public sector asset that it constructs or upgrades and then must operate and maintain for a specific period, but where revenue earned is contingent, as opposed to guaranteed). Under this model, the operator should recognise, for accounting purposes, an intangible asset to the extent that it receives a right (as it was the case in this concession agreement) to charge the users of the public service. This intangible asset should be measured at fair value.

Taking this into account, the court applied the National Accounting and Financial Reporting Standard 6, based in the International Accounting Standard 38 ("Intangible Assets"), under which it concluded that, for accounting purposes, the depreciation of the submerged land throughout the duration of the concession agreement was admissible.

From a tax perspective, the court considered that the PTA's position had ignored the fact that the submerged land was allocated to the concession activity and thus to the industrial exploitation of hydroelectric energy and use of water for watering.

Therefore, the court considered that the depreciation or amortisation of the submerged land at stake was admissible under Portuguese tax law since, on the one hand, such land was essential

for dam functioning and thus for the production of electric energy and use of water, and on the other hand, the land along the built infrastructure would revert to the Portuguese state at the end of the contract without charge. The court concluded that no contradiction existed between the applicable accounting and tax rules.

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